APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

95-5121, -5125

WELLS FARGO BANK, N.A.,
Plaintiff/Cross-Appellant,

v.

THE UNITED STATES,
Defendant-Appellant.

DECIDED: July 2, 1996

Before ARCHER, *Chief Judge,* FRIEDMAN, *Senior Circuit Judge,* and MAYER, *Circuit Judge.*

FRIEDMAN, *Senior Circuit Judge.*

This appeal and cross appeal challenge decisions of the United States Court of Federal Claims that (1) held that the Farmers Home Administration (the Administration) of the Department of Agriculture breached an agreement with the plaintiff/cross-appellant, Wells Fargo Bank, N.A. (Wells Fargo), to guarantee the bank's loan, *Wells Fargo Bank, N.A. v. United States,* 26 Cl. Ct. 805 (1992), and (2) awarded Wells Fargo $10,885,423.86 in damages. *Wells Fargo Bank, N.A. v. United States,* 33 Fed. Cl. 233 (1995). We affirm the determination of breach, part of the damages, and the denial of Wells Fargo's claim for additional damages, but reverse the major portion of the damages award.

I.

A. In 1972 legislation, Congress authorized the Administration to

> make and insure loans to public, private, or cooperative organizations . . . for the purpose of improving, developing, or financing business, industry, and employment and improving the economic and environtal climate in rural communities . . . . Such loans, when originated, held, and serviced by other lenders, may be guaranteed by the Secretary [of Agriculture] . . . .

Rural Development Act of 1972, Pub. L. No. 92-419, § 118, 86 Stat. 657, 663 (current version at 7 U.S.C. § 1932(a) (1994)), *reprinted in* 1972 U.S.C.C.A.N. 756, 763.

The Administration's regulations providing procedures for applying for loans and guarantees and determining such applications state:

> The purpose of the [business and industrial loan] program is to improve, develop, or finance business, industry, and employment and improve the economic and environmental climate in rural communities, including pollution abatement and control. This purpose is achieved through bolstering the existing private credit structure through guarantee of quality loans which will provide lasting community benefits. It is not intended that the guarantee authority be used for marginal or substandard loans or to "bail out" lenders having such loans.

7 C.F.R. § 1980.401(b) (1982). "Inability to obtain credit elsewhere is not a requirement for guaranteed assistance under [the business and industrial loan program]." *Id.* § 1980.425(a). An Administration official testified at trial, however, that "the purpose of the lender program is to get banks to make loans that they ordinarily wouldn't make. They are high risk loans."

Upon receipt of a request for a loan guarantee, the Administration evaluates the application and determines whether it may guarantee the loan. "If [the Administration] is able to guarantee the loan, it will provide the Lender and the applicant with Form FmHA 449-14 [Conditional Commitment for Guarantee], listing all requirements for such guarantees." 7 C.F.R. § 1980.452 (1982). This form contains the Administration's "advice to the lender that the material it has submitted is approved subject to the completion of all conditions and requirements set forth in 'Conditional Commitment for Guarantee.'" *Id.* § 1980.6(a)(4). The lender and applicant can review the conditions and requirements in the Conditional Commitment and decide whether to accept them, reject them, or propose alternate conditions. *Id.* § 1980.453.

Administration regulations state that once all requirements have been met, the Administration and the lender "will execute" both a lender's agreement detailing the lender's responsibilities and the loan note guarantee itself. *Id.* § 1980.61, 1980.6(a)(13). The regulations define "loan note guarantee" as "[t]he signed commitment issued by [the Administration] setting forth (specifically or by reference) the terms and conditions of the guarantee." *Id.* § 1980.6(a)(14). The maximum loss covered "can never exceed . . . 90 percent of the principal and interest indebtedness." *Id.* § 1980.20.

The regulations also provide the procedures when the Administration refuses to issue a loan note guarantee:

> If [the Administration] determines that it cannot execute the Loan Note Guarantee because all requirements have not been met, it will promptly inform the lender on Form FmHA 449-13, "Denial Letter" of the reasons, and give the lender a reasonable period within which to satisfy [Administration] objections. If the lender writes [the Administration] within the period allowed requesting additional time to satisfy the objections, [the Administration] may,

> in writing, grant such additional time as it considers necessary and reasonable under the circumstances. If the lender satisfies the objections within the time allowed, the guarantee will be issued.

Id. § 1980.61(d).

B. In the Biomass Energy and Alcohol Fuels Act of 1980, Pub. L. No. 96-294, tit. II, 94 Stat. 611, 683-712 (codified as amended in scattered sections of 7 & 42 U.S.C.), Congress found that "the dependence of the United States on imported petroleum and natural gas must be reduced by all economically and environmentally feasible means, including the use of biomass energy resources." *Id.* § 202(1), 94 Stat. at 683. Congress authorized loan guarantees for the construction of biomass energy projects, 42 U.S.C. § 8814 (1994), which include the production of ethanol, *see* 42 U.S.C. § 8812(a) (1994). That legislation requires that "the applicant for such loan . . . establish[] . . . that the lender is not willing without such a guarantee to extend credit to the applicant at reasonable rates and terms." 42 U.S.C. § 8814 (g)(1).

The Senate Committee Report on the act stated that

> [t]he loan guarantees . . . would spur farmers, farm cooperatives and industry to construct alternative energy production projects. Bankers and businessmen, who frequently are reluctant to invest in new endeavors and usually take a "wait and see" attitude would witness, first hand, the feasibility and great potential of these government assisted projects. Once government makes this commitment, bankers and businessmen will have the confidence to proceed with similar alternative energy projects using private capital and ingenuity.

S. Rep. No. 387, 96th Cong., 2d Sess. 48 (1980), *reprinted in* 1980 U.S.C.C.A.N. 1751, 1798.

The Administration promulgated regulations for the new program in October 1980. Biomass Energy and Alcohol Fuels Loans and Loan Guarantees, 45 Fed. Reg. 72,044 (1980). In July 1983, the Administration repealed those regulations, because:

> (1) No projects have been funded under the [Biomass Energy and Alcohol Fuels] program since its inception . . . . The provisions of the Act and subsequent regulations were not as attractive to applicants as the [Administration] Business and Industry (B&I) guaranteed loan program regulations.
>
> (2) Applicants who were pursuing alcohol fuel projects were more interested in the B&I regulations provisions; therefore, the Administration processed and funded such applications (15 originally) under those regulations.
>
> (3) No subsequent appropriations have been provided since the original appropriation for the Energy Act and it is unlikely Congress will provide funding for separate [Biomass Energy and Alcohol Fuels] projects. Current Congressional appropriation actions are recommending that alcohol fuel projects be financed under the current B&I regulations rather than under the original Energy Act.

Guaranteed Loan Programs, 48 Fed. Reg. 30,941, 30,941 (1983).

C. In the present case, the borrower, American Gasohol Refiners (American), in 1982 sought a $20,000,000 loan from Mid-Kansas Federal Savings and Loan Association (Mid-Kansas) to build an ethanol manufacturing plant in rural Kansas. Ethanol is an alcohol which may be blended with gasoline for use as fuel. Its price fluctuates depending upon changes in the prices of corn and other grains (from which it is made) and of oil. *See Worldwide: Wall St. Roundup HIGH PLAINS CORP. (HIPC),* Wall Street Transcript, Mar. 21, 1994; *Research*

Analyst Interview: BASIC BRANDED FOOD PRODUCTS, Wall Street Transcript, Aug. 8, 1994; *Broker Report: ARCHER DANIELS MIDLAND (ADM),* Wall Street Transcript, Sept. 12, 1994.

Mid-Kansas and American applied to the Administration for a guarantee of the loan. In the application, Mid-Kansas stated that it

> is pleased to sponsor and recommend this loan guaranty request to the [Administration]. We believe that this application and project are well planned, financially sound and properly suited for an [Administration] loan guarantee.

Mid-Kansas sought a guarantee of ninety percent of the loan.

In October 1982, the Administration issued a Conditional Commitment to Mid-Kansas and American, containing various conditions and stating that "[a] Loan Guarantee will not be issued until the Lender certifies that it has no knowledge of any adverse change, financial or otherwise, in the Borrower, his business, or any parent, subsidiaries, or affiliates since it requested a Loan Note Guarantee." The Conditional Commitment also stated that "[w]hen these conditions and requirements are met, Farmers Home Administration will issue a loan note guarantee in the amount of ninety percent."

In December 1982, Wells Fargo agreed to finance American's construction of the proposed ethanol plant. Subsequently, the Conditional Committee to Mid-Kansas and American (which changed its name to High Plains, *see Wells Fargo Bank, N.A.,* 26 Cl. Ct. at 807 n.2), which would have expired in 1983, was extended. The ethanol plant was built and began production in 1984, but "Wells Fargo and High Plains determined that an additional $3.5 million was necessary to bring the plant to full production." *Id.* at 807 (footnote omitted).

Wells Fargo, High Plains, the Administration, and several other interested parties executed an Intercreditor Agreement, dated September 9, 1985, "which addressed the terms and conditions under which additional financing would be advanced by Wells Fargo." *Id.* The Intercreditor Agreement extended the Conditional Commitment through June 1986, and stated that "[d]ue primarily to difficulties in achieving adequate production levels at the Plant, the [Administration] Guarantee has not issued." The Agreement also reaffirmed that "upon compliance with the conditions of the Commitment and [Administration] regulations, the [Administration] will issue the [Administration] Guarantee for the benefit of Mid-Kansas or if Wells Fargo [become]s the lead lender, for the benefit of Wells Fargo." A new Conditional Commitment naming Wells Fargo as the lead lender was executed in October 1986.

In April 1986, the Administration directed its state directors to notify "lenders holding a conditional commitment for an alcohol production facility" of ten items that it intended to consider "in order to assure there is no adverse change in the project prior to their closing of the loan." The items included "[c]urrent and future demand and markets for the product of the facility" and "[c]urrent and future prices of the product of the facility." Wells Fargo objected to this directive, stating that the consideration of price and other macro-economic factors in the decision whether to issue a guarantee was contrary to the policy goals of the loan guarantee program and to the understanding of the parties at the outset of the process.

In October 1986, the Administration wrote Wells Fargo that "we do not believe, based on the information submitted to date, that High Plains Corporation or Wells Fargo have met all conditions precedent to our issuance of the loan note guarantee." The letter stated fifteen respects in which High Plains and Wells Fargo's fulfillment of the conditions was deficient. Wells Fargo im-

mediately responded, answering the fifteen deficiencies and explaining how each of the conditions had been satisfied. Additional correspondence ensued, both between Wells Fargo and the Administration and within the Administration, some of which indicated that the Administration was satisfied with the bank's response and intended to issue the guarantee. Based on these discussions, Wells Fargo agreed to provide an additional $5,000,000 in financing for the project.

In a December 19, 1986, letter from the Administration's state director to Wells Fargo, however, the Administration stated that it was "unable to execute a Loan Note Guarantee." The Administration explained that it was refusing to execute the guarantee because "[t]here has been an adverse change in the financial condition of High Plains Corporation during the period of time between the issuance of the Conditional Commitment for Guarantee in 1982 and December 17, 1986." It referred to a Peat Marwick Mitchell and Company (Peat Marwick) report that "indicate[d] that based on the price of ethanol ($.80 per gallon) and the cost of milo [grain] ($1.23 per bushel), the company would not generate sufficient cash flow to meet its obligations as of October 1986, or in the foreseeable future." The Administration also asserted that "[t]he history of the management of the corporation reveals numerous decisions which have caused adverse results and led us to have serious concerns about the credibility of its management."

D. After the Administration refused to issue the loan guarantee, High Plains and Wells Fargo twice restructured the loan. As part of the first restructuring, Wells Fargo received options to purchase eighty-four percent of High Plains's stock and reduced the loan balance by $12,700,000. In the second restructuring, Wells Fargo surrendered the options in exchange for $2,500,000 in cash.

Following a public offering of its stock in 1993, High Plains paid its indebtedness to Wells Fargo with the ex-

ception of $389,423, which the bank forgave in exchange for receiving the proceeds of the public offering.

E. After the Administration denied an administrative appeal of the refusal to issue the guarantee, Wells Fargo filed a breach of contract suit in the United States Claims Court (the name of which in 1992 was changed to the United States Court of Federal Claims. For convenience's sake, we refer to the trial court by the latter name.)

In its opinion on liability, the court granted Wells Fargo's motion for partial summary judgment, holding that the Administration had contracted to issue the guarantee and had breached the contract. *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 805 (1992). The court ruled that both the 1982 Conditional Commitment and the later Intercreditor Agreement were valid "conditional contracts." *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 810. According to the court, the Conditional Commitment was a unilateral contract, under which the Administration's commitment to issue the guarantee became binding when the bank began performance by making the loan to American. *Id.* at 810-11. The court stated that " '[t]here is ample case law holding that a contractual relationship arises between the government and a private party if promissory words of the former induce significant action by the latter in reliance thereon.' " *Id.* at 810 (quoting *National Rural Utils. Coop. Fin. Corp. v. United States*, 14 Cl. Ct. 130, 137 (1988), *aff'd*, 867 F.2d 1393 (Fed. Cir. 1989)). In the court's view, both the Conditional Commitment and the Intercreditor Agreement "constitute contracts that bind the [Administration] to issue the guarantee if the conditions were satisfied. The [Administration] was not free to withdraw its offer or to refuse to determine if the conditions were, in fact satisfied." *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 811.

The court concluded that all of the conditions had been satisfied. *Id.* at 817. It rejected the Administration's claims that adverse changes had occurred in either the

financial condition or management of High Plains. The court ruled that the "first person for denying the gurantee, insufficient cash flow due to low ethanol prices," was "legally insufficient" because it was "based on conditions outside plaintiff's control for which the plaintiff did not assume the risk of forfeiture." *Id.* at 815. The court also rejected the Administration's concerns about adverse changes in company management, because many of the examples the Administration gave pre-dated the Intercreditor Agreement and "did not prevent the]Administration[from signing [it]," *id.* at 816, and also were known "prior to [the Administration] indicating informally that the guarantee would be issued." *Id.* at 817.

Following a separate trial on damages, the court awarded Wells Fargo $10,885,423.86. *Wells Fargo Bank, N.A.*, 33 Fed. Cl. at 236. This amount comprised two elements. The major portion—$10,496,000—was for profits Wells Fargo allegedly lost because it was unable to make additional loans following a capital restructuring required as a result of the government's refusal to issue the guarantee. *See infra* part III.A. The second item was the $389,423 that Wells Fargo forgave when it received the proceeds of High Plain's public stock sale. *Wells Fargo Bank, N.A.*, 33 Fed. Cl. at 245-46. The court, however, denied Wells Fargo's additional request for damages of up to $26,264,000, reflecting its alleged losses from the surrender of its equity interest in High Plains, because those losses did not "meet the standards of foreseeability and certainty." *Id.* at 248.

II.

The government challenges the rulings of the Court of Federal Claims (1) that there was a valid contract between the Administration and Wells Fargo that obligated the government to issue the guarantee upon Wells Fargo's compliance with the conditions, and (2) that the Administration breached the contract when it refused to

issue the guarantee because Wells Fargo had not satisfied the conditions.

A. The Court of Federal Claims correctly ruled that the Conditional Commitment constituted a unilateral contract by which the government agreed to guarantee the loan upon Wells Fargo's performance of the conditions specified, and that Wells Fargo accepted the contract though beginning performance by making the loan. As that court pointed out, " 'a contractual relationship arises between the government and a private party if promissory words of the former induce significant action by the latter in reliance thereon.' " *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 810 (quoting *National Rural Utils. Coop. Fin. Corp.*, 14 Cl. Ct. at 137). Here, following the issuance of the Conditional Commitment, in which the Administration "agree[d] . . . [to] execute" the "Loan Note Guarantee" (see *infra*), Wells Fargo accepted the government's offer by making the $20,000,000 loan to finance construction of the ethanol plant.

The government, however, argues that no contract was formed because "[u]nder [Administration] regulations, no Government official, not even one having authority to sign the guarantee at the proper time, had the authority to bind the United States to a loan note guarantee prior to compliance with all the regulatory requirements for issuance of a loan note guarantee." As the Court of Federal Claims correctly stated, however, "the issue at this point is not whether these offiicals had the authority to grant a guarantee, but whether these officials had the authority to obligate the [Administration] to a Conditional Commitment." *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 810 n.4. Administration officials were authorized to execute conditional commitments under the regulations implementing the business and industrial loan guarantee program. *See* 7 C.F.R. § 1980.452 (1982). That the guarantee could not finally be executed until the conditions were fulfilled is irrelevant in determining the validity of the Conditional Commitment.

Although Administration regulations characterize the Conditional Commitment as mere "advice" to the lender, *id.* § 1980.6(a)(4), the document itself shows that the government is making a binding promise:

> [T]he United States of America acting through the Farmers Home Administration (FmHA) hereby agrees that . . . it will execute Form(s) FmHA 449-34 "Loan Note Guarantee" subject to the conditions and requirements specified in said regulations and below.

Conditional commitments are signed by the Administration's state director, the lender, and the borrower. The document lists twenty-nine separate conditions that must be satisfied before the Administration issues the loan guarantee. These include such costly endeavors as obtaining insurance, establishing an escrow account, paving a road, obtaining permits, and providing extensive documentation to the Administration. No lender and borrower would be willing to undertake such steps in reliance on mere "advice" rather than a firm promise. Moreover, in reliance on the Conditional Commitment, Wells Fargo risked the $20,000,000 it furnished to High Plains.

That the government's promise to issue the loan guarantee was contingent upon High Plains and Wells Fargo's performance of numerous conditions does not make the promise any less binding. Indeed, the essence of a unilateral contract is that one party's promise is conditional upon the other party's performance of certain acts and when the other party performs, the first party is bound. *See M.K. Metals, Inc. v. Container Recovery Corp.*, 645 F.2d 583, 588 (8th Cir. 1981) ("'(a) contract condition which qualifies a duty of performance by a party does not make the existence or validity of the contract hinge on the condition'") (citation omitted); *Moratzka v. United States (In re Matthieson)*, 63 B.R. 56, 60 (D. Minn. 1986) ("[A] condition precedent is a condition precedent to performance under the contract, not formation of the contract. When a condition precedent is not

satisfied, it relieves a party to the contract of the obligation to perform. It does not negate the existence of the contract or the binding contractual relationship of the parties."). Although these cases did not involve unilateral contracts, they set out a general principle of contract law concerning conditional performance that is applicable to all types of contracts.

Thus, the "preguarantee audit," *see* 7 C.F.R. § 1980.454 (Administrative B) (1982), which the government contends was a " 'further [necessary] act of the offeror,' " *Cutler-Hammer, Inc. v. United States*, 441 F.2d 1179, 1182 (Ct. Cl. 1971) (citation omitted) that "negate(s) existence of a contract," *id.*, does not alter the government's commitment that once the conditions are satisfied, a loan guarantee will issue. The audit is only to ensure that all the conditions have been met, and "to assure that no adverse change has taken place," 7 C.F.R. § 1980.454 (Administrative B).

The government relies on and urges us to follow *Runnemede Owners, Inc. v. Crest Mortgage Corp.*, 861 F.2d 1053 (7th Cir. 1988), which it contends shows that it did not enter into a contract with Wells Fargo. That case involved a qualified commitment letter by a mortgage company relating to a projected loan to finance the purchase of a motel. *Id.* at 1054. The commitment was subject to the approval by the lender "in its sole discretion" of twenty specified items, including the income and expenses of the project. *Id.* at 1054, 1057. After substantial discussions, the lender refused to make the loan because it concluded that the anticipated cash flow from the motel would be insufficient to support the loan. *Id.* at 1055.

Applying Illinois law, the court of appeals affirmed the dismissal of the breach of contract claim. It described the commitment letter as "nothing more than an agreement to consider extending a loan, not an unqualified promise that such consideration would yield the financial

help desired." *Id.* at 1056. The court stated: "Because of Crest's determination, under the clear terms of paragraph IV, no binding contract to extend the loan arose. . . . Runnemede's interpretation runs contrary to the intent of the parties expressed in the conditional written commitment letter." *Id.* at 1057.

In the significantly different circumstances of the present case, in contrast, the Conditional Commitment created an obligation on the government to issue the guarantee if Wells Fargo made the loan and satisfied the other conditions. As the Court of Federal Claims correctly stated, this is an example of " 'a contractual relationship aris[ing] between the government and a private party [because] promissory words of the former induce[d] significant action by the latter in reliance thereon.' " *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 810 (quoting *National Rural Utils. Coop. Fin. Corp.*, 14 Cl. Ct. at 137). There is no provision in the Conditional Commitment comparable to the "in its sole discretion" language in *Runnemede.* To the contrary, the Conditional Commitment stated that, "when these conditions are met, [the Administration] will issue a loan note guarantee."

The fact that Mid-Kansas was the named lender in the 1982 Conditional Commitment and that Wells Fargo was not substituted as the lead lender until 1986 does not affect the binding nature of the 1982 commitment. The Administration was aware from the outset that Wells Fargo would provide the $20,000,000 financing for the ethanol facility. Furthermore, the 1986 Conditional Commitment that explicitly made Wells Fargo the lead lender stated that "[t]he Conditional Commitment for Guarantee and all items of conditions specified in the Conditional Commitment for Guarantee dated 10/1/82 and revised 12/15/82 continue in effect." Thus, the 1982 Conditional Commitment was fully applicable to Wells Fargo.

The 1985 Intercreditor Agreement, to which the Administration was a party, confirms that the earlier Condi-

tional Commitment was a binding undertaking by the Administration to issue the guarantee upon Wells Fargo's compliance with the conditions. The 1985 agreement, which covered the provision of additional financing for the ethanol plant by Wells Fargo, extended the Conditional Commitment through June 1986, stated that "[d]ue primarily to difficulties in achieving adequate production levels at the Plant, the [Administration] Guarantee has not issued," and reaffirmed that "upon compliance with the conditions of the Commitment and [Administration] regulations, the [Administration] will issue the [Administration] Guarantee for the benefit of Mid-Kansas or if Wells Fargo [become]s the lead lender, for the benefit of Wells Fargo."

Indeed, at no time during the protracted discussions regarding the issuance of the guarantee did the Administration ever state, or even suggest, that the Conditional Commitment did not constitute a binding undertaking by it to issue the guarantee. Implicit in those discussions was the Administration's recognition that it had made such a commitment and intended to carry it out. When the Administration finally refused to issue the guarantee, it relied not on the lack of a binding commitment to do so, but on changes in the borrower's situation that it alleged constituted a failure to comply with the conditions upon which the commitment was based.

B. The Conditional Commitment required that, before the Administration would issue the guarantee, "the Lender certif[y] that it has no knowledge of any adverse change, financial or otherwise, in the Borrower, his business, or any parent, subsidiaries, or affiliates since it requested a Loan Note Guarantee." Wells Fargo provided this certification.

The Administration nevertheless refused to issue the guarantee for two reasons: (1) "There has been an adverse change in the financial condition of High Plains Corporation during the period of time between the issu-

ance of the Conditional Commitment for Guarantee in 1982 and December 17, 1986." It relied on the Peat Marwick report that "based on the price of ethanol ($.80 per gallon) and the cost of milo ($1.23 per bushel), the company would not generate sufficient cash flow to meet its obligations as of October 1986, or in the foreseeable future." (2) "The history of the management of the corporation reveals numerous decisions which have caused adverse results and led us to have serious concerns about the credibility of its management."

We agree with the Court of Federal Claims that neither reason justified the Administration's refusal to issue the guarantee; and that since Wells Fargo had fulfilled all of the conditions of the Conditional Commitment, the Administration was required to issue the loan guarantee. *Cf. Winstar Corp. v. United States,* 64 F.3d 1531, 1545 (Fed. Cir. 1995) (in banc) ("When the plaintiffs satisfied the conditions imposed on them by the contracts, the government's contractual obligations became effective . . . ."), *cert. granted,* 116 S. Ct. 806 (1996).

High Plains's alleged financial problems resulting from low ethanol prices and high grain prices were the very kinds of economic risks that were inherent in the ethanol manufacturing business. It was those risks that underlay the loan guarantee program. As an Administration official testified, "the purpose of the lender program is to get banks to make loans that they ordinarily wouldn't make. They are high risk loans."

Whatever financial problem High Plains may have had as a result of these price fluctuations, it was not an "adverse change . . . in the Borrower, [or] his business" within the meaning of the certification clause of the Conditional Commitment. That provision related to changes in High Plain's own internal financial condition, not to changes in the markets in which High Plains operated and did business.

The low price of ethanol and high price of the grain from which it was made had not dissuaded the Administration in the latter part of 1986 from telling Wells Fargo that "[if] Wells Fargo provides [an additional $5,000,000 to High Plains], then [the Administration] is satisfied with the projected economics of this project." The Peat Marwick report, on which the Administration relied, questioned High Plains's continued viability only if there were no loan guarantee and no additional $5,000,000 financing. The report did not evaluate the company's financial situation if Wells Fargo provided that additional financing, as it did.

With regard to the company's alleged management problems, the Administration had been aware of nearly all of them for a long time, and until the final decision letter, did not raise them as problems during the discussions about the company's viability. Several of the items had occurred prior to the Intercreditor Agreement and the issuance of a new Conditional Commitment with Wells Fargo as the lead lender, apparently on the assumption that the loan guarantee process was proceeding as planned. Indeed, despite the supposedly significant management problems, shortly before the Administration's refusal to issue the guarantee the Administration's administrator wrote a member of the House of Representatives that the process was "culminating in the granting of the guarantee." We agree with the Court of Federal Claims that "[t]he evidence offered by the [Administration] in the December 19th letter to support their allegation of poor management by High Plains does not support a finding that an adverse change had taken place." *Wells Fargo Bank, N.A.*, 26 Cl. Ct. at 816-17.

III.

"The general rule in common law breach of contract cases is to award damages that will place the injured party in as good a position as he or she would have been in had the breaching party fully performed." *Estate of*

Berg v. United States, 687 F.2d 377, 379 (Ct. Cl. 1982); *Northern Helex Co. v. United States*, 524 F.2d 707, 713, 720 (Ct. Cl. 1975), *cert. denied*, 429 U.S. 866 (1976). However, "remote and consequential damages are not recoverable in a common-law suit for breach of contract . . . . especially . . . in suits against the United States for the recovery of common-law damages, such as the instant case." *Northern Helex Co.*, 524 F.2d at 720. Moreover, attempting to determine what could have happened if the guarantee had been issued necessarily involves a highly speculative and conjectural inquiry.

The government challenges both items of damages the Court of Federal claims awarded for the government's breach of the contract to issue the guarantee: (A) $10,496,000 for the profits the court determined Wells Fargo lost as a consequence of the breach and (B) $389,423 of High Plains's indebtedness that Wells Fargo forgave when it received the proceeds of High Plains's public stock offering. We reverse on the first item, and affirm on the second.

A. 1. The Court of Federal Claims awarded lost profits damages on the following theory:

A bank's ability to make loans from the deposits it receives is limited by its capital. For each dollar of Wells Fargo's capital, it could make loans of fifteen dollars. As a result of the Administration's refusal to issue the guarantee and the poor quality of the High Plains loan, Wells Fargo charged off $9.7 million on the loan, which "resulted in an equal reduction to Wells' capital. This capital reduction lessened the ability of Wells to make loans of up to 15 times the amount of the charge-offs—the approximate capital leverage ratio for the bank at the time. The lost income on these allegedly foregone loans was quantified by Wells' expert to be $6,849,000.00, which was based on a 14% average rate of return on Wells' lending business for the preceding years." *Wells Fargo Bank, N.A.*, 33 Fed. Cl. at 239.

In addition, the risky character of the High Plains loan precluded Wells Fargo from treating interest payments it received on the loan as income. "[T]hat would have increased Wells' capital by the same amount. This loss was temporary because the High Plains loan eventually reached the 'recovery phase' in March 1990, at which time all payments were booked as income. Just as with the charged-off capital, Wells argues this temporarily lost capital would have been put to a profitable use. Wells' expert calculated the lost earnings from loans this capital could have supported, and accounted for the recoupment that occurred during the recovery phase of the High Plains loan. These damages were quantified at $3,647,000.00, which essentially represent the time value of the lost earnings caused by the temporary loss of capital. In sum, the total debtside damages claimed by Wells is $10,885,423.86." *Id.* at 240.

The court held that Wells Fargo was entitled to recover "the lost profits resulting from the capital losses caused by the government's breach." *Id.* at 246. The court ruled that "[t]he effect of the charge-offs and the loan's non-accrual status (i.e., inability to book interest as income when received) were clearly foreseeable in this case due to the nature of the [Administration's] loan guarantee program, and the regulated nature of the banking industry. . . . [t]he lost capital damages claimed by Wells were foreseeable at the time of contracting, and . . . there was no intervening causal step between the government's breach and the damages claimed by Wells." *Id.* at 247.

2. Our predecessor court, the Court of Claims, in breach of contract cases repeatedly refused to award damages for profits lost on transactions not directly related to the contract that was breached. *See Roberts v. United States,* 18 Cl. Ct. 351, 358 (1989) (citing Court of Claims cases denying lost profits damages). Of course, not every injury resulting from a breach of contract is remediable in damages. *Globe Ref. Co. v. Landa Cotton Oil Co.,* 190 U.S. 549 (1903).

In *Ramsey v. United States*, 101 F. Supp. 353 (Ct. Cl. 1951), *cert. denied*, 343 U.S. 977 (1952), where the government delayed payment on contracts with the plaintiff, the court, in denying lost profits damages, stated:

> The profits lost from the corporation's over-all business activities, because of its shortage of capital allegedly occasioned by the Government's failure to pay the contract amounts when due, may not be recovered either. It is important to bear in mind that the corporation's claim is not for the anticipated profits of the contracts in question, but is a claim for the anticipated profits of its entire business enterprise. The lost profits of these collateral undertakings, which the corporation was unable to carry out, are too remote to be classified as a natural result of the Government's delay in payment. . . . "[T]here is a distinction by which all question[s] of this sort can be easily tested. If the profits are such as would have accrued and grown out of the contract itself, as the direct and immediate results of its fulfillment, then they would form a just and proper item of damages, to be recovered against the delinquent party upon a breach of the agreement. . . . But if they are such as would have been realized by the party from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, then they are too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit."

Id. at 357-58 (quoting *Myerle v. United States*, 33 Ct. Cl. 1, 26 (1897)).

This reasoning is equally applicable to the present case. Here the Court of Federal Claims awarded damages for the profits Wells Fargo allegedly would have made on the additional loans it could have made if the guarantee had been issued. Like the lost profits in *Ramsey*, Wells Fargo's

loss of interest on additional loans it allegedly could have made had there been no breach is "too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit."

In *Olin Jones Sand Co. v. United States,* 225 Ct. Cl. 741 (1980), the Court of Claims refused to award damages to a company that, as a result of government wrongdoing, lost its bonding capacity and therefore was unable to obtain unrelated contracts. *Id.* at 743-44. *See also Rocky Mountain Constr. Co.,* 218 Ct. Cl. 665, 666 (1978) (damages claim that had government not delayed contract performance, plaintiff would have profited from other contracts on which it would have bid, held legally insufficient); *Northern Helex Co.,* 524 F.2d at 720-21 ("[A]uthorities support our denial of plaintiff's claim for the costs of the operation of its plant to the end of the contract term in connection with its nonfederal work with its related companies, because such costs are too remote, speculative, an[d] consequential to be compensable as damages."); *William Green Constr. Co. v. United States,* 477 F.2d 930, 936 (Ct. Cl. 1973) ("[I]n a common law suit there would be no recovery for general loss of business, the claimed loss of the entire Green net worth, and losses on the non-federal work—such damages are all deemed too remote and consequential."), *cert. denied,* 417 U.S. 909 (1974).

The cases Wells Fargo cites are not to the contrary. In *Neely v. United States,* 285 F.2d 438 (Ct. Cl. 1961), lost profits damages were permitted when the government breached an agreement to lease land for mining. *Id.* at 442. There, however, the profits lost on the mine were caused directly by the breach and were proven with certainty. Unlike the present case, the profits lost in *Neely* were profits on the use of the subject of the contract itself. Indeed, the only purpose of the contract in *Neely* and the other cases was for the plaintiff to make profits on the subject of the contract—through mining, dairy cow operations, or property resale.

In the present case, in contrast, the purpose of the guarantee was to enable Wells Fargo to make profits from the interest on its loan to High Plains, not on some other loans it might make. The only portion of the damages the Court of Federal Claims awarded that directly resulted from the failure to issue the guarantee was the $389,423 of the indebtedness that Wells Fargo wrote off—the award of which, as explained in part III.B below, we uphold.

In awarding lost profits damages, the Court of Federal Claims stated that "the main issue before the court with regards to whether or not the lost capital damages are recoverable is whether they were foreseeable at the time of contracting." *Wells Fargo Bank, N.A.*, 33 Fed. Cl. at 247. The court rejected the "defendant's interpretation of the case law that lost profits from unrelated business transactions are never recoverable against the federal government. Rather, the court interprets the case law cited by the government—cases in which lost profits from unrelated business transactions were denied—to have been decided on foreseeability grounds." *Id.* at 247 n.11. As our prior discussion shows, we approach the question differently, and do not agree with the Court of Federal Claims's holding that "the lost capital damages claimed by Wells were foreseeable at the time of contracting, and that there was no intervening causal step between the government's breach and the damages claimed by Wells." *Id.* at 247.

B. Unlike the lost profits damages, which we have concluded were too remote and uncertain, the $389,423 of High Plains's indebtedness that Wells Fargo wrote off when it received the proceeds of High Plain's public stock offering in satisfaction of that indebtedness was a direct result of the government's breach of its contractual obligation to issue the guarantee.

If the government had issued the guarantee, it would have used a standard form which would have stated:

> The guaranteed portion of the loan is $[18,000,000] which is [90] (%) percent of loan principal. . . . [T]he United States of America . . . will pay to: A. Any Holder 100 percent of any loss sustained by such Holder on the guaranteed portion . . . ."

7 C.F.R. § 1980.83 App. A—Form FmHA 449-34, Loan Note Guarantee (1982).

The regulations governing the guarantee provided that "[t]he maximum loss covered by the Form FmHA 449-34, "Loan Note Guarantee," can never exceed . . . 90 percent of the principal and interest indebtedness as evidenced by said note(s) or by assumption agreement(s)." *Id.* § 1980.20.

We read this language as providing that the government would pay 100 percent of any loss on the guaranteed portion of the loan, but not more than ninety percent of the total indebtedness. At the time of the write-off, Wells Fargo already had charged off two million dollars of High Plains's twenty million dollar indebtedness to it. The eighteen million dollar balance was satisfied by Wells Fargo's receiving the proceeds of High Plains's public stock offering and writing off the remaining balance of $389,423.

If the guarantee had been issued, Wells Fargo would have been entitled to recover the $389,423, because (1) the guaranteed portion of the loan (ninety percent of the twenty million dollar indebtedness) was eighteen million dollars and (2) the government agreed to pay 100 percent "of any loss sustained on the guaranteed portion" of the loan. By accepting $389,423 less than the guaranteed portion of the loan, Wells Fargo suffered a loss in that amount.

Furthermore, unlike the lost profits, which were not foreseeable when the government executed the Conditional Commitment, it was foreseeable that if the government breached its obligation to issue the guarantee, the

lender would suffer a loss on its loan to High Plains. Indeed, it was the likelihood of loss on this risky loan that led the lender to seek the guarantee. Wells Fargo's loss of the $389,423 portion of its loan to High Plains was one of the contingencies against which the guarantee was intended to protect the lender.

The government contends, however, that the award of $389,423 would constitute interest on interest, the payment of which an Administration regulation currently prohibits. 7 C.F.R. § 1980.11 (1996). The argument relates to the 1987 and 1989 restructuring of High Plains's loans and Wells Fargo's accounting treatment of payments High Plains made to it in connection therewith. As the Court of Federal Claims explained, the government "essentially argues the payments received from High Plains should have been used to reduce principal on the customer balance; thus the remaining $389,423.86 would constitute interest upon interest. However, there was no evidence presented at trial that this would have been appropriate or consistent with industry or regulatory accounting standards." *Wells Fargo Bank, N.A.*, 33 Fed. Cl. at 246. Indeed, the only testimony on this point was that the bank treated the $389,423 as principal.

Like the Court of Federal Claims, we are "unwilling to accept the recharacterization of payments urged by the government." *Id.*

IV.

Wells Fargo's cross-appeal challenges the Court of Federal Claims's refusal to award it damages for its alleged loss on surrendering, in the second restructuring of the High Plains loan, for $2,500,000, the options to purchase eighty-four percent of High Plains's stock it had acquired in the first restructuring of that loan. Wells Fargo argues that, if the guarantee had issued, it would not then have surrendered the equity interest but instead either would have sold it for much more or retained part of it. According to its expert, it suffered a loss on surrender of its

equity interest ranging from $18,277,000 to $26,264,000. *Id.*

The Court of Federal Claims rejected these damage claims because (1) they did not "meet the standards of foreseeability and certainty," and (2) "failed to establish that the value of the equity was an *interest* protected by the contract. While the [Administration] might have foreseen that Wells was going to acquire an equity interest in High Plains, it does not follow that the [Administration] could have foreseen that the denial of a loan guarantee would cause a loss to debt turned into equity which was never intended to be guaranteed." *Id.*

We agree. These damages are even more remote and conjectural than the lost profits damages that we have disallowed. Our analysis of those damages in part III.A also requires the conclusion that the Court of Federal Claims correctly denied Wells Fargo these additional damages.

CONCLUSION

The judgment of the Court of Federal Claims is reversed insofar as it awarded Wells Fargo lost profits damages of $10,496,000. It is affirmed insofar as it awarded Wells Fargo damages of $389,423 and denied Wells Fargo additional damages for the surrender of its options to acquire High Plains stock. The case is remanded to the Court of Federal Claims to enter judgment in favor of Wells Fargo for $389,423.

AFFIRMED-IN-PART, REVERSED-IN-PART, AND REMANDED

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

95-5121, -5125

WELLS FARGO BANK, N.A.,
Plaintiff/Cross-Appellant,

v.

THE UNITED STATES,
Defendant-Appellant.

Judgment

ON APPEAL from the United States Court of Federal Claims in CASE NO(S). 51-88C.

This CAUSE having been heard and considered, it is ORDERED and ADJUDGED:

AFFIRMED-IN-PART, REVERSED-IN-PART, AND REMANDED.

ENTERED BY ORDER OF THE COURT

/s/ Francis X. Gindhart
FRANCIS X. GINDHART
Clerk

Dated Jul. 2, 1996

ISSUED AS A MANDATE: September 18, 1996

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

Case No. 51-88C
Filed: Apr. 11, 1995

WELLS FARGO BANK, N.A.,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

Breach of Contract to Issue Guarantee; Lost Capital Damages; Foreseeability; Certainty

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SMITH, Chief Judge

OPINION

This case comes before the court to determine damages for breach of contract. The court has previously found liability against the Farmers Home Administration (FmHA) for breaching its contract with Wells Fargo Bank to issue a loan note guarantee pursuant to the government's ethanol loan guarantee program. *Wells Fargo Bank, N.A. v. United States,* 26 Cl.Ct. 805 (1992). The government's ethanol loan guarantee program sought to achieve various policy goals, including the development of alternative, renewable energy sources, the creation of an enlarged grain market, and the promotion of increased employment in rural areas. The highly uncertain economic viability of ethanol caused private lenders to deny loans

for the construction of ethanol plants. Accordingly, the ethanol loan guarantee program was designed to provide incentives to lending institutions by guaranteeing 90% of the financing needed to construct ethanol plants. In this case, the program succeeded in inducing Wells' to finance the construction of an ethanol plant. The company constructing the ethanol plant was High Plains Corporation.

The contract breached in this case was a unilateral contract that consisted of documents entitled "Conditional Commitment for Guarantee" and "Intercreditor Agreement." These documents contained conditions to be met by Wells in return for the FmHA's issuance of the guarantee. The existence of these documents induced Wells to perform by lending High Plains the necessary funds to construct an ethanol plant. The plant was constructed and was operating, apparently profitably, at the time of the trial. In this court's previous opinion on liability the court found that a valid contract existed and that the FmHA breached its obligation to issue the guarantee.

Trial on damages presented the court with the unique task of determining what the absence of a guarantee cost the plaintiff, even though the loan never defaulted. The basic issues presented were whether Wells suffered any damage because of the breach, whether the damages claimed were foreseeable by FmHA, and whether the damages claimed have been quantified to a reasonable degree of certainty. For the reasons stated in this opinion the court awards Wells Fargo damages in the amount of $10,885,423.86.

FACTS

A. The Banking Industry.

The liability, or non-asset, side of a bank's balance sheet primarily consists of deposits and equity. Deposits comprise a large liability item on a bank's balance sheet, and come in a variety of forms. A significant portion of a bank's deposits are insured by the federal government, and

it is deposits that banks use to conduct their lending business. A bank's lending activity is accomplished by leveraging its capital. The amount of capital determines how much lending a bank can do. For example, if a bank is operating at a 5% capital to asset ratio, it can hold 20 dollars of assets (i.e., loans to customers) for every dollar of capital invested by its shareholders. Banks do not lend out their capital, but instead use their capital to support a highly leveraged liability structure. Therefore, when a bank has a dollar of capital it can go out and raise deposits from the public, both insured and uninsured. It is by managing this liability structure, or "sources of funding" as banks call it, that a bank can build its balance sheet, and build its asset base. *See* Tran. 399. Wells' highly credible expert, Nevins D. Baxter, testified that typically 50-85% of a bank's assets are loans, with the remainder constituting risk-free government securities or cash. This is true in part because national banks are generally prohibited from owning stock, except when acquired as part of a loan restructuring. Accordingly, the asset side of a bank's balance sheet consists mostly of loans, with comparatively few assets derived from fee generating businesses.

The banking industry is highly regulated. Mr. Baxter testified that the focus of the federal regulators' attention is on capital levels and asset quality. The "legal lending limit" regulates the amount a bank can loan relative to its capital. Tran. 391. Bank examiners rate banks on a scale of 1 to 5; 1 denotes a healthy bank and 5 denotes a bank that has gone out of business. Larger banks typically have resident regulators that monitor their capital levels and asset quality year round. Banks also have internal procedures that monitor asset quality. When these procedures are sound, and followed, the regulators have more confidence in the objectivity of the bank's internal system. This leads to less scrutiny, and less over the shoulder regulation. Most important these procedures

are in the best interest of depositors, stockholders, and consistent with sound banking practices.

Banks are required to maintain certain minimum capital to asset ratios. However, regulators insist, and bank management certainly wants, a capital to asset ratio higher than the regulatory minimum. Regulators are not comfortable having banks approach the regulatory minimum, and bank management wants to present the bank to the marketplace as a safe institution. Accordingly, the regulatory minimum is in actuality a danger level. If a bank is even close to the regulatory minimum there is usually a problem. When a bank gets in trouble it begins to liquidate its assets to avoid approaching the regulatory minimum. Baxter testified that Wells Fargo has historically been well above the regulatory minimum, but that Wells Fargo has been more heavily leveraged than other large banks. *See* Plaintiff's Exhibit 20x.

The quality of loans (the bank's principal assets) are also monitored by a rating system. Loans are classified on a 9-point scale; 1 signifies an excellent trouble-free loan, and 9 signifies a total loss. The majority of loans are actually somewhere on the continuum between 1 and 9, depending on the quality of collateral, the timeliness of payments, and the general risks associated with the borrower's business. For example, a loan rated as 5 or 6 may go on a "watch list" or "special mention list" which triggers certain internal policies and procedures the bank uses to work with the borrower to cure any deficiencies. If a loan is rated 7 or 8 it would probably be classified as "substandard" or "doubtful." As the classification reaches 7 or 8 the likelihood that bank regulators will require specific "loan loss reserves," or in the extreme case a partial or total "charge-off," dramatically increases.

A charge-off is the writing off of a portion of a loan believed to be no longer collectible. Charge-offs reflect the bank's and the regulator's view about the current value of the loan as an asset. A charge-off corresponds to a de-

crease in the bank's capital, and reduces the bank's income in the period taken. This capital loss prevents the bank from growing its business by leveraging the lost capital in accordance with its capital to asset ratio. In extreme cases charge-offs may even cause the bank to liquidate assets if its capital to asset ratio reaches a danger level.

The quality rating of a particular loan also affects the accounting treatment of payments received from the borrower. As a loan moves down the continuum from 1 to 9 it will eventually be classified as a non-performing loan for accounting purposes. Loans are classified as non-performing if there are serious or constant delinquencies by the debtor in scheduled payments, or if there is a substantial decrease in the value of collateral, regardless of whether the debtor is current on payments. The idea being that either of these events raise doubts about the ultimate collectibility of the loan. When a loan is non-performing regulators require the bank to use either "non-accrual" or "cash basis" accounting depending on the severity of risk. Accrual status means the bank is allowed to book interest payments as income when scheduled, whether or not they have been received from the borrower. Cash basis status means the bank is allowed to book interest payments as income only when they are received from the borrower. Non-accrual status means the bank is not allowed to book any payments as income until the bank balance of the loan is zero. That is, until the loan is being carried at zero value on the bank's books. Moreover, when a loan is on non-accrual status the bank is usually required to establish a reserve against it.[1] This rigid accounting system is a result of the regulators' concern that risky assets not be represented at unrealistic or inflated values.

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[1] Although economic damage may also have occurred from "loan loss reserves" in this case, Wells Fargo is not claiming this as an element of damage.

There is a critical distinction in bank accounting between "bank balance" and "customer balance." Banks essentially have two sets of accounting books for any particular loan. The bank balance of a loan reflects the accounting treatment of the loan as an asset to the bank. The customer balance of a loan reflects the accounting treatment of the loan between the bank and the borrower, as reflected in the legal terms of the note.[2] Throughout the life of any loan the borrower is supposed to make payments of interest and principal as scheduled pursuant to the terms of the loan, and these payments are applied to reduce the customer balance. However, because the bank balance consists of only the principal amount of the loan, payments may affect the bank balance differently. Scheduled interest payments on a performing/accrual status loan are booked as income to the bank when scheduled—which increases the bank's capital, and only principal payments are applied to reduce the bank balance. This is the ideal situation for the bank because it can book interest as income at the earliest possible time. Increased capital enhances the bank's ability to expand its lending business, or pay dividends to its stockholders.

B. Wells Fargo's Dealing with High Plains.

The ethanol plant construction loan from Wells to High Plains was supposed to be guaranteed by the federal government. However, the FmHA refused to issue the loan guarantee in December 1986, and Wells proceeded to work with High Plains over several years in an effort to get the plant operating and profitable with the goal of securing repayment of the monies owed. High Plains had a low liquidation value, and Wells Fargo believed it was in its best interest to work with High Plains to get and keep the company alive and in a position to service its now unguaranteed debt. However, soon after

[2] Regulators are concerned with the bank balance accounting, while borrowers are generally concerned with the customer balance accounting.

the guarantee was denied, national bank examiner Jens Jensen informed Wells Fargo that he believed the loan was a total loss and that Wells should charge-off the entire High Plains loan. *See* Tr. 120.

After FmHA denied Wells' administrative appeal in mid-1987—thus leaving no chance the guarantee would issue—Wells approached High Plains about restructuring its outstanding debt. In September 1987, Wells and High Plains agreed to restructure the $32,656,789.00 outstanding debt in a fashion similar to what would have occurred at the December 1986 guarantee closing. In essence, $12.7 million of the debt was converted to options to purchase 84% of High Plains' stock, and High Plains' loan balance was reduced to $20,000,000.00. The term of the loan was stated at ten years with a fixed interest rate of 12.23%. However, given the riskiness of the loan a much higher interest rate was justified, but 12.23% is the highest rate High Plains could service.

In 1988, a drought occurred which narrowed the spread between grain and ethanol prices. This was so because grain prices went up while ethanol, which sold in an unrelated market affected largely by oil prices, did not. This resulted in severe financial stress for High Plains. It was also during this period that Wells succumbed to increasing regulatory pressure and charged-off $9.7 million of the High Plains loan: $6.7 million on December 30, 1988, and $3 million on March 15, 1989.

By March 1989, it had been several months since High Plains made any principal or interest payments, and its efforts at a public stock offering to raise capital had been unsuccessful. Also, Wells was under continuous regulatory pressure to charge-off the remaining bank balance of the High Plains loan. In May 1989, a group of foreign investors was interested in purchasing High Plains, but they were unwilling to do so while Wells retained warrants entitling it to 84% of High Plains' stock. Accordingly, High Plains' management approached Wells about a sec-

ond restructuring that would require Wells to relinquish the warrants, but as a precondition to considering a second restructuring, Wells required High Plains to turn over $548,000.00 in cash it had been holding.[3]

The parties finally agreed to a second restructuring in May 1989. Wells also agreed to relinquish the Warrants for $2.5 million in cash, and restate the loan at $20,903,-526.25: $19,451,663.43 in principal and $1,451,862.82 in accrued interest. The term of the loan was converted to a 30-year amortization with a balloon payment due after five years, and the interest rate was fixed at 10%. Wells also obtained an agreement from High Plains that any excess cash not needed for immediate business purposes would be paid to Wells. All payments received by Wells were used to reduce the bank balance of the loan. The bank balance of the High Plains loan was reduced to zero by March 1990, but the customer balance remained at $20,210,000.00.

The second restructuring anticipated High Plains' ability to retire the Wells debt within five years through a public stock offering. In March 1993 this was accomplished, with a relatively small shortfall of $389,423.86. Wells agreed to waive the $389,423.86 shortfall in order to receive the $17,689,244.01 net proceeds of the sale. This all or nothing approach was made necessary by the rules governing security offerings.

C. Damages Claimed by Wells.

1. Debtside Damages.

a. The Shortfall from the 1993 Public Offering.

In 1993, High Plains finally found itself in a position to conduct a public offering potentially capable of retiring the Wells Fargo debt. Wells and High Plains agreed to

[3] High Plains had no incentive to turn over these funds prior to this time because it was not enough to bring the High Plains loan current.

proceed with the offering only if it provided a minimum of $17.5 million. The customer balance on the High Plains loan was $18,078,667.87 at the time. The net proceeds of the 1993 offering amounted to $17,689,244.01 (1.9 million shares at $10.25 per share—less the costs of the offering). Wells agreed to waive the shortfall of $389,423.86 if it received all the proceeds of the offering. If the loan guarantee from FmHA had issued, Wells argues, it would not have waived this remaining principal amount because it would have been covered by the guarantee.

b. Lost Capital Damages.

Because of the FmHA's breach, Wells was left with a risky unbankable loan as opposed to a relatively risk-free government guaranteed loan. Accordingly, federal banking regulators exerted pressure on Wells to reduce the bank balance of the High Plains loan as fast as possible. Because of this pressure Wells was forced to take charge-offs of $9.7 million on the bank balance of the High Plains loan. These charge-offs resulted in an equal reduction to Wells' capital. This capital reduction lessened the ability of Wells to make loans of up to 15 times the amount of the charge-offs—the approximate capital leverage ratio for the bank at the time. The lost income on these allegedly foregone loans was quantified by Wells' expert to be $6,849,000.00, which was based on a 14% average rate of return on Wells' lending business for the preceding years.[4]

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[4] Wells also calculated a damage figure based on a hypothetical stock repurchase program using the $9.7 million in lost captial. *See* Plaintiff's Exhibit 20bb, 20cc, 20dd. Under this scenario, the damage figure was actually higher, approximately $12.254 million. Under either scenario, the basic premise underlying the lost capital analysis is that banks use capital as profitably as possible. Banks set target floors for capital retention and attempt to employ all "excess" capital above this minimum, whether through loaning, stock repurchasing, dividends, etc. That is, if a bank finds itself with "excess" capital, it is unintended, and the bank is sure to

The second aspect of Wells' lost capital damages involves the method by which banks are permitted to account for risky loans. High-quality/low-risk loans are treated on an accrual basis; the bank can book interest payments from the borrower as income when they are scheduled under the terms of the loan, regardless of when they are received. If a loan has some problems but its collectibility is ultimately assured (i.e., guaranteed by the United States) then the bank is usually allowed to book interest payments due under the loan as income when they are actually received from the borrower. This is called cash basis accounting. If the loan is risky and its ultimate collectibility is in doubt, the bank must usually treat the loan on a non-accrual basis. Because of the FmHA's breach in this case Wells was forced to treat the High Plains loan on a non-accrual basis, as opposed to a cash basis. As a result, Wells temporarily lost the ability to book interest payments received from High Plains as income; income that would have increased Wells' capital by the same amount. This loss was temporary because the High Plains loan eventually reached the "recovery phase" in March 1990, at which time all payments were booked as income. Just as with the charged-off capital, Wells argues this temporarily lost capital would have been put to a profitable use. Wells' expert calculated the lost earnings from loans this capital could have supported, and accounted for the recoupment that occurred during the recovery phase of the High Plains loan. These damages were quantified at $3,647,000.00, which essentially represent the time value of the lost earnings caused by the temporary loss of capital. In sum, the total debtside damages claimed by Wells is $10,885,423.86.

The government argues that an additional $5 million in financing would have been required as a condition precedent to the issuance of the guarantee, and that this would significantly affect Wells' lost capital damage calculation.

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quickly put it to profitable use. This premise was clearly supported at trial.

The government's contention in this regard is questionable for several reasons. Wells persuasively argues in its post-trial brief that even if the $5 million was made available it would not have been used, and that under no circumstances would its lost capital damages be reduced by more than $1.025 million. The additional $5 million in short-term financing was actually a settlement offer by Wells which the government refused. Furthermore, it would have been a unilateral change to the contract for the government to demand the additional financing in a backdoor attempt to reduce the size of its guarantee and shift part of the risk of loss to Wells. As it turned out, High Plains did not need the additional financing, and even if it was provided it would have been illogical to use it to pay long-term debt.

2. *Equityside Damages.*

After the FmHA breached its agreement to issue the loan note guarantee, Wells and High Plains restructured their loan in 1987. This restructuring was similar to one that was intended to occur within the context of the 1986 guarantee closing. The 1986 closing anticipated a debt-for-equity exchange to improve High Plains balance sheet.[5] At the time High Plains owed over $32 million to Wells Fargo. Wells agreed to exchange $12.7 million in debt (the amount over the original $20 million) for warrants on 84% of High Plains stock. If the guarantee had issued Wells was looking to the equity as a "store of value" to recover monies owed above the guaranteed amount. *See* Tran. 478-480.

By May 1989 High Plains was again in financial distress due in part to a drought in 1988. At this time Wells agreed to a second restructuring. In the May 1989 re-

[5] The 1986 loan note guarantee closing anticipated Wells exchanging about $7 million in debt for equity, and forgiving outright about $5 million in debt. This is the only apparent distinction from what actually occurred in 1987.

structuring, Wells agreed to sell the equity back to High Plains for $2.5 million. Wells insists it sold the equity solely to reduce the bank balance on the High Plains loan because it was under pressure from federal regulators. This evidence is both logical and uncontradicted. If the guarantee had issued Wells argues it would have held onto the equity to maximize its value, and eventually would have sold it to recover unguaranteed funds owed by High Plains. Wells argues it would have sold 60% of the equity no earlier than March 1993 for $18,360,000.00, and retained the balance having an estimated value of $12,240,000.00. After making adjustments for discounts and the amount received from the actual sale of warrants in 1989, Wells' expert calculated the total adjusted loss on the equity as $26,264,000.00. As an alternative theory, Wells posits that if it had sold half the equity in the 1989 restructuring, and the remaining half in 1993, the total adjusted loss would be $18,277,000.00.

In sum, the total amount of damage claimed by Wells is $37,149,423.86 or $29,162,423.86, depending on which equityside figure is used.

DISCUSSION

A. General Principles.

In a case for breach of contract the goal of compensation is not the mere restoration to a former position, as in tort, but the awarding of a sum which is the equivalent of performance of the bargain. Stated differently, compensation is not ordinarily the value of the contract, but the value of its performance to plaintiff. 11 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 1139 & 1343 (3d ed. 1968). Generally, the attempt is to place the plaintiff in the position he would be in if the contract had been fulfilled. CHARLES TILFORD MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 137 (1935); 11

WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1338 (3d ed. 1968).

In awarding appropriate compensation the court must assess gains prevented as well as losses suffered which would not have occurred had the contract been performed. 11 WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1338 (3d ed. 1968). As late as 1853, one who failed to carry out his contract was, so far as legal theory went, liable for any and all resulting loss sustained by the other party no matter how unforeseeable such loss may have been. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 137 (1935).

However, in 1854 the English Court of Exchequer handed down an opinion in the landmark case of *Hadley v. Baxendale*, 9 Exch. 341, 156 Eng. Rep. 145 (1854), which has furnished the general standard by which English-speaking courts test claims for breach of contract. The case was brought by the owner of a gristmill against a carrier for delay in delivering a shipment consisting of broken pieces of the gristmill shaft. The carrier was told that the mill was stopped, and that the shaft must be sent immediately, but he was not told that the stoppage of the mill was solely on account of the broken shaft, or that no other shaft was available. The plaintiff claimed damages for lost profits due to the idleness of the mill, and the jury allowed the claim. The court, however, stated:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

McCormick, Handbook on the Law of Damages § 138 (1935) (citing *Hadley v. Baxendale*).[6]

The court in *Hadley* held that the notice given was not sufficient to apprise the carrier that the delay would cause the mill to main idle. McCormick, Handbook on the Law of Damages § 138 (1935). Because unlimited liability had previously been the legal standard for contract breach, the main significance of the case lies not in the dictum that if notice is given liability will attach. Rather, the history making influence of the case lies in the decision that liability will not attach for damage which was not "in the contemplation" of the parties "at the time they made the contract." McCormick, Handbook on the Law of Damages § 138 (1935). The standard is ob-

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[6] Although the main principle of *Hadley v. Baxendale* is to subject all contract claims to the test of foreseeability, it also highlights a distinction between "general" and "special" damages. Confusion sometimes results from the use of the term "consequential" to refer to harm suffered as a "consequence" of the breach of duty, but not as a *direct* or *immediate* or *foreseeable* consequence (each of the modifiers of "consequential" is, of course, a legal conclusion). It seems that "consequential damages" is a term that is used loosely as a synonym of "special" as opposed to "general" damages. The court agrees with Professor Corbin that "[t]he use of this expression should be abandoned," 5 Arthur Linton Corbin, Corbin on Contracts § 1011 (1964), though it is probably too late in the day for this. If such damages are not recoverable it is for reasons of economic logic or for failure of proof. Damages are held to be recoverable if they flow *naturally* or *ordinarily* from the breach of contract itself. Such damages are supposed to have been in the contemplation of both parties as the probable, obvious, or even presumptive result of the breach. However, damages that have occurred because of the specific breach, but do not always immediately result from that type of breach, are more difficult to recover. In order to recover these damages the plaintiff must show that defendant had reason to know of specific circumstances related to the injury that existed at the time of entering the contract. McCormick, Handbook on the Law of Damages §§ 138 & 140 (1935); 5 Corbin, Corbin on Contracts § 1011 (1964); 11 Williston, A Treatise on the Law of Contracts § 1344A (3d ed. 1968).

jective and takes account of what the defendant, who made the contract, might then have reasonably anticipated, in light of the facts known to him, and does not confine the inquiry to what he actually did anticipate. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 138 (1935) (citing *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1902)); 5 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1009 (1964). The principle of *Hadley v. Baxendale* has been universally accepted, and there has been little variation of the original phraseology in the use of the principle by American courts, whose opinions still repeat the formula that damages are limited to the "natural and probable consequences" and those which in the light of the facts of which they had knowledge, were "in the contemplation" of the parties. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 138 (1935)(citing cases).[7] Note, however, the rationale applied by Judge Posner in *Evra v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982), and *Rardin v. T. & D Machine Handling, Inc.*, 890 F.2d 24 (7th Cir. 1989).

Under federal law the principle of *Hadley* is stated somewhat differently. In *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903), Justice Holmes

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[7] This "foreseeability" or "contemplation" doctrine is the only substantial test for the legal requirement as to "proximate" causation. 5 CORBIN, CORBIN ON CONTRACTS § 1007 (1964). With respect to *losses* suffered by a plaintiff the question of foreseeability of the injury is often determined with the aid of hindsight. However, the problem is different in the case of gains that have been prevented by the defendant's breach of contract. These "profits" have not occurred, and the court must determine whether or not they would have occurred if there had been no breach. The problem with lost profits involves the making of an often very complex prediction. 5 CORBIN, CORBIN ON CONTRACTS § 1007 (1964). *See also Finley v. United States*, 31 Fed. Cl. 704 (1994) (plaintiff's claim for lost profits denied as being too "speculative"). What would have been the sequence of events if the defendant had not breached, when in fact it did?

found that a breaching party can only be found liable for damages if it can be fairly "presumed [the defendant] would have assented [to] if they had been presented to his mind." *Globe Refining Co.*, 190 U.S. at 543; *see also Prudential Insurance Co. v. United States*, 801 F.2d 1295, 1300 (Fed. Cir. 1986); *Rocky Mountain Construction Co. v. United States*, 218 Ct.Cl. 665 (1978); *Northern Helex Co. v. United States*, 524 F.2d 707, 714-15 (Ct.Cl. 1975); *Ramsey v. United States*, 121 Ct.Cl. 426, 433 (1952); *Myerle v. United States*, 31 Ct.Cl. 1 (1897). That is, the extent of liability "depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made." *Globe Refining Co.*, 190 U.S. at 544.[8]

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[8] It should be noted, however, that this particular phrasing of the *Hadley v. Baxendale* rule has not been universally accepted. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 141 n.56 & n.57 (1935); 5 CORBIN, CORBIN ON CONTRACTS § 1008 n.4 (1964); 11 WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 1356 n.8 & 1357 n.4 (3d ed. 1968). In particular, Professor Williston criticizes the language used in *Globe Refining Co.* as follows:

> To assert . . . that the measure of damages for breach of a contract is based on the terms of the contract is to assert a fiction which obscures the truth and invites misapprehension which may lead to error. [citing *Globe Refining Co.*] One who, on borrowing money, agrees to pay it the following month does not stipulate for the alternative right to keep the money at legal interest until the lender can get judgment and levy execution, although this is the only remedy the law can enforce. . . . Parties generally have their minds addressed to the performance of contracts—not to their breach or the consequences which will follow a breach. *The fiction here criticized is a manifestation of the broader fiction that parties contract for whatever obligations or consequences the law may impose upon them.*

11 WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1357 (3d ed. 1968) (emphasis added).

The formulas of notice and contemplation, and what courts attempt to do when applying them, can be best described as follows:

> The formula is one for use in determining whether the *interest* involved is protected by the agreement. And it is not a contemplation of *consequences* from a possible breach, but a contemplation of *interests* which may be protected by the contract. Parties, in making contracts, rarely contemplate *the losses* which would result from its breach. But they do count the advantage they will gain from its performance. *What interests does the contract promote or serve?* These are actually considered in most part, and those which are shown to have been considered or reasonably falling within the terms in view of the language used and the background of the transaction, mark its boundaries—the limits of protection under it.

McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 141 n.60 (1935)(quoting GREEN, RATIONALE OF PROXIMATE CAUSE 51 (1927)(emphasis in original)).

The "certainty" rule is an additional standard requiring a reasonable degree of persuasiveness in the proof of the amount as well as the fact of damage. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 26 (1935); *see also* 11 WILLISTON, A TREATISE ON THE LAW OF CONTRACTS §§ 1345-1347 (3d ed 1968); 5 CORBIN, CORBIN ON CONTRACTS §§ 1020-1028 (1964). In traditional phraseology, the "certainty" requirement is usually accompanied by the statement that the damages must not be "contingent," "conjectural," or "remote." McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 25 (1935). These terms are not classifications of damages, but instead characterize a situation where the evidence fails to prove to a reasonable degree of certainty what would have occurred if the defendant had not breached the contract. In short, the damages must be capable of ascertainment by

reference to some definite standard, either of market value, established experience, or direct inference from known circumstances. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 26 n.11 (1935).

Although courts uphold the standard of certainty as an ideal, the following modifications of the rule have developed to avoid harsh applications:

(a) If the fact of damage is proved with certainty, the extent or amount may be left to reasonable inference.

(b) Where the defendant's wrong has caused the difficulty of proof of damage, he cannot complain of the resulting uncertainty.

(c) Mere difficulty in ascertaining the amount of damage is not fatal.

(d) Mathematical precision in fixing the exact amount is not required.

(e) If the best evidence of the damage of which the situation admits is furnished, this is sufficient.

McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 27 (1935) (citing *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931)); *see also Del Mar Avionics, Inc. v. Quinton Instrument Co.*, 836 F.2d 1320, 1327 (Fed. Cir. 1987); *Lam, Inc. v. Johns-Manville Corp.*, 718 F.2d 1056, 1065 (Fed. Cir. 1983); *Locke v. United States*, 151 Ct.Cl. 262, 267 (1960).

Loss of commercial profits remains the usual field for the application of the standard of certainty. McCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 28 (1935); *see Also Goolsby v. United States*, 21 Cl. Ct. 88 (1990); *Jackson v. United States*, 12 Cl. Ct. 363 (1987). In proving a claim for loss of profits of an established business, the record of past profits is usually the best available evidence. McCORMICK, HANDBOOK ON THE LAW OF DAM-

AGES § 29 (1935); 11 WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1346A (3d ed. 1968); 5 CORBIN, CORBIN ON CONTRACTS § 1023 (1964). These profits are not necessarily too uncertain of realization for recovery of damages, even though they are dependent on the uncertain conduct of customers and of competitors. If the business is one that is established, a reasonable prediction can often be made as to its future on the basis of its past history. 5 CORBIN, CORBIN ON CONTRACTS § 1023 (1964); *see also McDermott v. Middle East Carpet Co., Asso.*, 811 F.2d 1422, 1428 (11th Cir. 1987) ("Where . . . a claimant can show a 'track record' of profitability, evidence can be considered and lost profits can be awarded"). Moreover, when concrete data of past profits is furnished an expert witness having special experience in the field may interpret the data by giving an expert opinion as to the probable profits that would have been made. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 29 (1935).

B. Wells' Damages.

The government's initial argument is that if any damages are recoverable they must be limited by the terms of the guarantee. In the court's view this argument misses the crux of the plaintiff's case. The guarantee contract is not the contract that was breached in this case; it was never entered into. Here the breached contract was the government's promise to issue the guarantee if Wells satisfied the conditions in the Commitment Letter and Intercreditor Agreement. The amount of the guarantee would be a limitation on damages only if the guarantee had been issued, Wells called the guarantee, and some dispute arose concerning how much the government must pay. Under the government's theory there would never be any consequence for breach when it wrongfully chose not to issue a guarantee. That is, it would have been indifferent *ex ante* regarding its decision to issue the guarantee or breach;

either way its maximum exposure is 90% of principle plus 100% of interest. Here the government's promise was to issue the guarantee, and it is this initial contract that was breached. Accordingly, this is the focus of the court's inquiry, and the government's argument that damages must be limited to the terms of the guarantee misconstrues the nature of the contract and the breach at issue.

At bottom this case is about risk shifting. The government promised Wells it would not have to bear the significant risks associated with providing a construction loan for an ethanol plant. The sole purpose of FmHA's ethanol loan guarantee program was to induce banks to provide financing for ethanol producing concerns when they otherwise would not do so. The reason they would not is because good banking practices would not allow the risks associated with ethanol plant loans. This was the reason for the government's guarantee policy which served to achieve a public policy goal that the market would not otherwise engage in. To put it another way, it was a method of the public subsidizing the creation of an ethanol industry at a hopefully lower cost than directly giving the money to ethanol producers.

The banking industry is highly regulated by the federal government, due in part to federal deposit insurance. Federal bank regulators severely restrict the ability of banks to engage in risk lending with depositor money. This in turn leads prudent banks to be extremely cautious in their lending activities. The consequences for banks of risky lending can be extreme even if the downside risk never materializes, and the potential upside for risk taking is strictly limited. Because of the nature of the banking industry and its regulatory environment, banks with risky assets suffer immediate consequences. In short, banks are not venture capitalists, but instead make money by managing highly regulated and comparatively risk-free liability structures. The federal government actively strives

to maintain this conservative lending environment in order to insure the stability of the banking system.

However, there are occasions where this conservative lending environment impedes what the government believes are socially desirable activities—such as the production of alternative fuel sources. Accordingly, if the government wishes to promote risky, but otherwise socially desirable lending activity, it must bring the risks associated with such loans in line with the conservative banking system it has created. One way the government does this is by counterbalancing lending risk with a government guarantee. This was the essence of the bargain in this case.

Given the regulated nature of the banking industry, the value of the government guarantee promised in this case goes beyond the mere promise of payment in the event of default by High Plains. A guarantee is essentially an insurance policy, and insurance policies have value even if the risk insured against never materializes. However, the question the court faces here is whether any damage was suffered because of the government's failure to issue the "insurance policy" it promised after the plaintiff had performed the conduct sought. For example, if a life insurance company breaches a contract to issue a life insurance policy to an individual, there may be no financial consequences provided the individual does not die during the term of insurance. This is the analogy the government wants the court to make in this case. Even assuming arguendo it breached the contract, the government argues Wells has suffered no financial loss because it recouped more dollars than it lent out on this particular transaction with High Plains. However, these are not the facts of this case.

The government's analogy does not fit when the "insured" is a federally regulated commercial bank. The analogy would be complete if, for example, the individual who has wrongfully refused a life insurance policy was required by law to freeze a portion of his assets—

to pay liabilities—in an effort to hedge against the risk of "uninsured" death, or was forbidden from engaging in certain kinds of employment without life insurance. This is precisely how the banking system operates. Bank regulators require banks to deal with risk *ex ante,* regardless of whether or not the risk ever materializes. Banks prefer to do this by collateralizing loans or receiving third party guarantees. However, when these methods are not available bank regulators require banks to deal with risks by taking charge-offs, making loan loss reserves, or altering the accounting treatment of risky loans. By breaching its promise to issue the guarantee in this case, the government shifted the risk associated with the High Plains loan to Wells, and Wells was required to deal immediately with that risk through the use of charge-offs and special accounting. Accordingly, the damages claimed in this case spring directly from the risk the government wrongfully thrust upon Wells.

In the court's view there is no doubt that Wells has suffered substantial economic consequences due to the government's breach. However, the more difficult issue is whether *all* the damages claimed by Wells were foreseeable at the time of contracting, and have been quantified to a reasonable degree of certainty. The court concludes that Wells has satisfied the contract law standards of foreseeability and certainty with regards to the debtside damages, but not as to the equityside damages.

1. Debtside Damages.

The debtside damages claimed by Wells essentially fall into two analytical categories: (1) the $389,423.86 shortfall from the 1993 public offering, and (2) the lost capital damages.

a. The Shortfall from the 1993 Public Offering.

The government does not dispute the $389,423.86 claimed by Wells on foreseeability or certainty grounds.

The only argument the government raises as to this part of the debtside damages is that it represents interest upon interest which is prohibited by regulation. 7 C.F.R. § 1980.11. This argument essentially boils down to an issue of accounting on the customer balance of the High Plains loan.

The FmHA guarantee would have covered 90% of principal and 100% of interest on the original $20 million loan.[9] The government says that because the 1987 and 1989 restructuring involved the recapitalization of interest exceeding $389,423.86, this element of damage constitutes prohibited interest on interest. However, the court agrees with Wells' position that the $389,423.86 represents the remaining *principal* owed on the customer balance after the 1993 public offering.

Banks routinely apply payments from borrowers to interest first, and principal second, on the customer balance of loans. In this case the "bank" and "customer" balances looked different in 1993. On the bank balance all payments were being booked as interest income because the loan had essentially been written off and was in the recovery phase. However, the customer balance—the legally enforceable balance—was not affected by the bank balance accounting so that the remaining $389,423.86 represented *principal* that would have been covered by the guarantee.

The government's argument challenges how Wells applied the payments it received from High Plains on the customer balance. It essentially argues the payments received from High Plains should have been used to reduce

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[9] Before the government's breach Wells charged-off the $2 million portion of the original $20 million loan that would *not* have been covered by the guarantee, and Wells is not acking for damages as a result of this particular charge-off. Accordingly, the principal on the bank balance of the original $20 million loan as of December 1986 was $18 million, all of which would have been covered by the guarantee.

principal on the customer balance; thus the remaining $389,423.86 would constitute interest upon interest. However, there was no evidence presented at trial that this would have been appropriate or consistent with industry or regulatory accounting standards. Accordingly, the court is unwilling to accept the recharacterization of payments urged by the government, and will award Wells the $389,423.86 claimed.

b. Lost Capital Damages.

The second analytical category of the debtside damages claimed by Wells is more complex; the lost profits resulting from the capital losses caused by the government's breach. The government's effort to contest the methodology used by Wells' expert to quantify Wells' claim is specious. The government argues that "average rates of return" are too speculative because they do not account for the possibility that the foregone loan opportunities may have been uncollectible. The government is simply wrong in this regard. Averages by definition account for the entire range of possibilities based on the bank's prior history. Here, Wells' used an average rate of return of 14% based on its actual historical experience, *see* Plaintiff's Exhibit 20i, and the government does not challenge the accuracy of Wells' figures in this regard.

The court also rejects the government's argument that 28 U.S.C. § 2516(a) or *Wickman Contracting Co., Inc. v. Fischer*, 12 F.3d 1574 (Fed. Cir. 1994), bar Wells' lost profits claim. Section 2516(a) was not intened to single out lending institutions by barring their claims for lost profits because their profits take the form of interest on loans. Nor is Wells, contrary to the facts in *Wickman*, asking for an average rate of return on its lost capital. Banks do not lend out their capital. Rather, banks lend out deposits in accordance with their capital to asset ratio; the more capital, the more deposits the bank is permitted to lend. It is the interest on these forgone loans—which

resulted from the lost capital—that Wells is seeking to recover.

Equally absurd is the government's argument that no damage occurred because Wells has not specifically identified customers that were turned down for loans because of the government's breach. Not only would such a requirement be asking Wells to prove a negative, but it is not the proper framework for the court's inquiry. The question before the court is not whether Wells has proven it could not make particular loans because of the government's breach, but whether Wells could have made more loans but for the government's breach. For example, if Wells was in the business of selling widgets, and the government's breach caused part of its business to shut down for a year, Wells certainly would be entitled to recover profits on lost widget sales *without having to identify every customer who did not buy a widget from Wells because of the government's breach.* Based on Wells' business history, the testimony of its corporate officers, and Wells' expert testimony, the court finds that Wells has provided the best evidence available to quantify the profits it lost because of the government's breach. McCormick, Handbook on the Law of Damages §§ 27 & 29 (1935) (citing *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 1931)); *see also Del Mar Avionics, Inc. v. Quinton Instrument Co.*, 836 F.2d 1320, 1327 (Fed. Cir. 1987); *Lam, Inc. v. Johns-Manville Corp.*, 718 F.2d 1056, 1065 (Fed. Cir. 1983); *Locke v. United States*, 151 Ct.Cl. 262, 267 (1960). The government does not seriously challenge the bulk of the economic or statistical methodology used by Wells' expert. *See* Plaintiff's Exhibits 20l, 20m, 20n, 20p, 20ff. Accordingly, the main issue before the court with regards to whether or not the lost capital damages are recoverable is whether they were foreseeable at the time of contracting.[10] Specifically, Wells

[10] It is unnecessary to the court's anaylsis or conclusions in this case to express an opinion on the case law cited by plaintiff indi-

is claiming that the charge-offs, and its inability to book interest as income when received, resulted in $10,496,000.00 in lost profits from its diminished lending capacity.

The court finds that Wells has met the standard of the *Hadley v. Baxendale* rule on foreseeability of lost profits. *Johns-Manville Corp. v. United States,* 13 Cl.Ct. 72, 161-62 (1987), *vacated on other grounds,* 855 F.2d 1571 (Fed. Cir. 1988); *see also Prudential Insurance Co. v. United States,* 801 F.2d 1295, 1300 (Fed. Cir. 1986); *Rocky Mountain Construction Co. v. United States,* 218 Ct.Cl. 665 (1978); *Northern Helex Co. v. United States,* 524 F.2d 707, 714-15 (Ct.Cl. 1975); *Ramsey v. United States,* 121 Ct.Cl. 426, 433 (1952); *Myerle v. United States,* 33 Ct.Cl. 1 (1897).[11] The sole purpose of the FmHA program was to alleviate the very type of risk of loss that occurred in this case. The effect of the charge-offs and the loan's non-accrual status (i.e., inability to book interest as income when received) were clearly foreseeable in this case due to the nature of the FmHA's loan guarantee program, and the regulated nature of the banking industry. The government's argument to the contrary is

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cating that the time of breach controls the foreseeability determination. *See e.g., Gardner Displays Co. v. United States,* 171 Ct.Cl. 497, 505 (1965).

[11] The court does not accept defendant's interpretation of the case law that lost profits from unrelated business transactions are never recoverable against the federal government. Rather, the court interprets the case law cited by the government—cases in which lost profits from unrelated business transactions were denied—to have been decided on foreseeability grounds. *But see Prudential Insurance Co. v. United States,* 801 F.2d 1295, 1302-03 (Fed. Cir. 1986) (Nichols, J., concurring) ("The inadequacy of 'foreseeability' alone to distinguish allowable from unallowable items of cost or loss, is plain. Even though antecedently considered, injury to the other party is not only 'possible,' but even 'probable,' in case of a breach it may not be allowable. . . . [It is naive to treat] the ostensible test of 'foreseeability' as the real one.")

It is also questionable as to whether, in this case, the foregone loans were "unrelated business transactions."

not credible. It is not disputed that the individuals involved on both sides of this transaction were seasoned and sophisticated bankers. Moreover, these damages are not dependent on the success or failure of High Plains as a going concern. Without a guarantee on the High Plains loan, capital losses were automatic regardless of High Plains payment history. From the outset, the threat of capital losses—and their ramifications—hung over this transaction like the sword of Damocles. This is precisely why Wells sought the FmHA Guarantee, and precisely why FmHA was in the business of issuing such guarantees. In short, the court holds that the lost capital damages claimed by Wells were foreseeable at the time of contracting, and that there was no intervening causal step between the government's breach and the damages claimed by Wells.

Wells' lost capital analysis does require the court to make one logical inference: that banks employ capital as profitably as possible. Banks are in the business of leveraging their capital, in this case at ratios of 15 to 1. Accordingly, banks do not intentionally let capital remain idle above a minimum "cushion" amount set by the bank's board to assure compliance with regulatory minimum capital levels.[12] The government argues that the lost capital in this case fell within the cushion, and would not have been used. The government cites the lack of any internal contemporaneous memos from Wells indicating that it was capitally constrained, or had insufficient capital to conduct its business. The government argues that Wells had plenty of capital to do its business and did not need, nor would have used, the capital it lost because of the

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[12] The amount of cushion capital a bank has depends on the particular bank involved, but in most cases the amount of capital a bank allows to remain idle is well above the regulatory minimum. However, the evidence presented at trial showed that Wells' was a more aggressive lender than other banks of similar size (i.e., that Wells maintained less of a capital cushion than other banks in its peer group). *See* Plaintiff's Exhibit 20x.

government's breach. The court finds the government's argument is flawed in two respects.

First, the lack of contemporaneous evidence that Wells was capitally constrained refutes rather than supports the government's argument that the lost capital claimed here would have remained idle "cushion" capital. Rather, the lack of contemporaneous evidence that Wells was capitally constrained supports Wells assertion that this lost capital was not "cushion" capital, and would have been employed as profitably as possible. Second, the issue is not whether Wells would have expended resources to raise additional capital to conduct more business, but whether Wells could and would have profitably employed the capital it already contracted for and lost due to the government's breach. When viewed from this perspective, there is no doubt Wells would have put the lost capital claimed here to a profitable use. Moreover, the court fails to see the relevance in the government's broader argument that Wells made "enough" money on this transaction, or was not "stoped in its tracks" because of the government's breach. A breach that causes a profitable contract to be less so is just as compensable as a breach that causes a negative cash flow or total loss. To rule otherwise would impose a means test on the "victims" of contract breach. While Wells' first dollar in profit may be more important to it than its millionth, it does not follow that the government is not liable for preventing gains Wells otherwise would have reaped but for the government's breach. Accordingly, the court will award Wells $10,496,000.00 in lost capital damages. The combinations of this amount with the $389,423.86 award for the shortfall discussed above results in a total award of $10,885,423.86 in debtside damages.

2. *Equityside Damages.*

In 1987 Wells acquired warrants for stock as part of the first restructuring of the High Plains loan. As part

of the second restructuring in May 1989, Wells agreed to sell the equity back to High Plains for $2.5 million. Wells insists it sold the equity solely to reduce the "bank balance" on the High Plains loan because it was under pressure from federal regulators. However, the government argues Wells probably thought the stock was "worthless" at the time, and that given the future prospects of the company $2.5 million in hand was better than the uncertain future value of the stock. *See* Defendant's Exhibit 33. Wells asserts it was still looking to the equity as a "store of value" even though the equity was actually acquired post-breach as part of the September 1987 restructuring. *See* Plaintiff's Brief at 9 (quoting transcript). Wells argues that if the government had issued the guarantee it would have sold 60% of the equity no earlier that March 1993 for $18,360,000.00, and retained the rest having an estimated value of $12,240,000.00. Wells' expert calculated the total adjusted loss on the equity as $26,264,000.00. As an alternative theory, Wells posits that if it had sold half the equity in the 1989 restructuring, and the remaining half in 1993, the total adjusted loss would be $18,277,000.00.[18]

Unlike the debtside damages, the court finds that the damages claimed here do not meet the standards of foreseeability and certainty. Most importantly, Wells has failed to establish that the value of the equity was an *interest* protected by the contract. While the FmHA might have foreseen that Wells was going to acquire an equity interest in High Plains, it does not follow that the FmHA could have foreseen that the denial of a loan guarantee would cause a loss to debt turned into equity which was never intended to be guaranteed. Wells alleges that it went ahead with the equity acquisition in 1987 still believing the equity represented a store of value to recover sums over $20 million despite knowing the government had breached its agreement to issue the guarantee. The

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[18] The stock values used by Wells' expert are based on the actual 1998 public offering.

likelihood that Wells might have to sacrifice the equity at a low price to reduce the bank balance was known when it acquired the equity; the very crux of plaintiff's case is that pressure from regulators to reduce the bank balance was foreseeable from the moment of the government's breach. In sum, the court concludes that the risk of High Plains' stock value was always on Wells' account.

Moreover, even if the government did not breach, High Plains stock value would have been unpredictable. The amount of these damages, unlike the debtside damages, is totally dependent on the success or failure of High Plains as a going concern under a hypothetical scenario where the guarantee had been issued. If the guarantee had been issued, it is possible—if not likely—that Wells would have called the guarantee within the first two years. In this situation the debt and equity would have been held by two separate entities. Wells would have held the equity, and the FmHA would have held the debt. This scenario creates completely different dynamics from what actually occurred. With an additional player—the FmHA—the ability of High Plains to even stay in business, no less achieve the 1993 stock price, is questionable. The point here is that the stock value actually achieved in 1993 is not necessarily probative on what, if any, value High Plains stock may have had under the guarantee scenario.

Even the experts disagree as to exactly how Wells would have disposed of the stock if the guarantee had issued. Wells' own expert gives two alternative possibilities, both of which seem equally plausible: (1) that Wells would have sold 60% of the equity in 1989 and 40% in 1993; or (2) that Wells would have held all the equity until 1993 at which time it would have sold part of the equity. *See* Plaintiff's Exhibits 20q, 20r. The reason both seem plausible is that Wells probably had mixed motivations in selling the equity for $2.5 mililon. These two alternatives produce a swing in the damage calculation of approximately $8 million. Stated simply, the court would be con-

jecturing if it granted an award based on what Wells might have done, with equity of uncertain value, under a completely hypothetical situation. While this, no doubt, has the effect of understating Wells' actual loss, this result is mandated by our law's requirement of a relatively high degree of certainty in light of the very limited human ability to predict the future. Accordingly, the court is unable to award Wells' any damages based on the equity it held in High Plains.

This result maybe somewhat harsh since it is arguable that but for the government's breach Wells would not have been under any regulatory pressure to reduce the bank balance any faster than the customer balance. Thus, the primary goal of Wells would have been to use the stock to at least recover the $12.7 million in loans (over the guarantee) that had been converted into stock warrants. If this case was a tort action, a case might well be made for awarding Wells the difference between the $2.5 million it recovered and the $12.7 million cost basis of the stock warrants. However, judges are not allowed to craft awards that they believe are just and fair. Rather, they are bound by legal rules to decide what the law commands. To do otherwise would be to violate the judges' oath. So, while to truly make Wells whole might require an additional $10 million equityside award, the law that this court must apply does not allow such a remedy in this case. As the late Senior Circuit Judge Philip Nichols, Jr. noted in *Prudential Insurance Co. of America v. United States*, 801 F.2d 1295 (Fed. Cir. 1986):

> The inadequacy of damages in case of government contract breach has become anomalous in contrast to the generosity with which damages are today awarded in other contexts. While damages are supposed or imagined to provide a disincentive to violating the legal rights of others, the government here may even enjoy incentives to commit such violation in some circumstances, when equitable relief and tort liability

> are both unavailable. I am not advocating judicial lawmaking, however. The matter would appear to call for congressional attention as it involves the waiver of sovereign immunity.

801 F.2d at 1303 (Nichols, J., Concurring).

CONCLUSION

Contract law exists to ensure that non-breaching parties receive the benefit of their bargains. In this case the government bargained for the creation and maintenance of an ethanol plant to promote its alternative energy source policy. The ethanol facility created by High Plains and Wells Fargo was built and is still in operation. In other words, the government received the benefit of its bargain. Wells Fargo, on the other hand, bargained for a bankable asset free from the risk of charges to the bank's capital. Wells did not receive this. Instead, Wells Fargo, like Charlie Brown, had the government's enticing guarantee "pulled away" at the last minute. Accordingly, Wells was left with an unbankable loan, that through its own efforts it was able to almost completely recover. However, these efforts were not without cost. Because of the government's breach Wells Fargo incurred the costs of dealing with a problem loan detailed in this opinion. Wells Fargo deserves compensation for these costs in order to receive the benefit of its bargain. Accordingly, the court concludes that Wells has suffered damages due to the government's breach of its promise to issue the loan note guarantee, and the court will award Wells damages in the amount of $10,885,423.86.

IT IS SO ORDERED.

/s/ Loren A. Smith
LOREN A. SMITH
Chief Judge

[Filed Apr. 17, 1995]

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

No. 51-88 C

WELLS FARGO BANK, N.A.,

v.

THE UNITED STATES

JUDGMENT

Pursuant to the court's opinion of April 11, 1995,

IT IS ORDERED AND ADJUDGED this date, pursuant to Rule 58, that plaintiff recover of and from the United States the sum of $10,885,523.86. Cost to plaintiff.

DAVID A. LAMPEN
Clerk of Court

April 17, 1995

By: /s/ [Illegible]
Deputy Clerk

[Filed Sep. 11, 1996]

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

95-5121, -5125

WELLS FARGO BANK, N.A.,
Plaintiff/Cross-Appellant,

v.

THE UNITED STATES,
Defendant-Appellant.

ORDER

A combined petition for rehearing and suggestion for rehearing in banc having been filed by the CROSS-APPELLANT, and the petition for rehearing having been referred to the panel that heard the appeal, and thereafter the suggestion for rehearing in banc having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the suggestion for rehearing in banc be, and the same hereby is, DECLINED.

Dated: September 11, 1996

FOR THE COURT
FRANCIS X. GINDHART
Clerk

By: /s/ Brian P. LeDuc
BRIAN P. LEDUC
Associate Chief
Deputy Clerk

UNITED STATES CLAIMS COURT

WELLS FARGO BANK, N.A.,
Plaintiff,

v.

THE UNITED STATES,
Defendant.

July 21, 1992

OPINION

SMITH, Chief Judge.

This case is before the court on cross-motions for summary judgment. Wells Fargo Bank, N.A., alleges that the Farmers Home Administration (FmHA) refused to issue a loan guarantee, and that this act constitutes a breach of contract. Wells Fargo sought this loan from the FmHA, under the authority of a 1980 amendment to the Consolidated Farm and Rural Development Act which sought to encourage the development and construction of non-fossil fuel sources. In the alternative, plaintiff contends that actions of the FmHA led plaintiff to believe that the guarantee would be issued and that the FmHA is thus estopped from denying the guarantee. Plaintiff also alleges that the FmHA was unjustly enriched in relation to the servicing of the debt on a fluorocarbon plant, and that plaintiff is entitled to damages in *quantum meruit*. Damages sought are in excess of $25 million.

Upon reviewing the motions and hearing oral argument, the court concludes that the plaintiff's major claims are

within the jurisdiction of the Claims Court, that a contract existed between the parties, and that the government is liable for any damages flowing from its breach of that contract. Therefore, for the reasons set forth below, defendant's motion for summary judgment with respect to the contract claims is denied, and plaintiff's cross-motion for partial summary judgment is granted. With respect to plaintiff's *quantum meruit* claim, this court does not possess jurisdiction, and the defendant's motion for summary judgment is granted as to this issue.

FACTS

In June 1982, American Gasohol Refiners, Inc. (AGRI) applied to the United States Department of Agriculture, Farmers Home Administration (FmHA) for a guarantee on a $20 million loan for the construction of a fuel ethanol plant. Under the loan guarantee program, the FmHA guaranteed payment of loans for ethanol plants, provided that the borrower and the lender bank fulfilled the terms of a Conditional Commitment for Guarantee [1] (Conditional Commitment) issued by the FmHA. The guarantee would require the FmHA to share in any losses suffered by the lender if the project failed.

In October 1982, the FmHA issued a Conditional Commitment listing AGRI as the borrower who would build and operate the ethanol plant and Mid-Kansas Federal Savings and Loan of Wichita (Mid-Kansas) as the lender. The Conditional Commitment indicated that the FmHA would guarantee 90% of the loan if certain conditions were met. The Conditional Commitment was signed by the FmHA, AGRI, and Mid-Kansas. The Conditional

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[1] The Conditional Commitment lists the requirements that must be met before a guarantee is issued. FmHA regulations define the Conditional Commitment as "FmHA's advice to the lender that the material it has submitted is approved subject to the completion of all conditions and requirements set forth in 'Conditional Commitment for Guarantee.'" 7 C.F.R. § 1980.-6(a)(4).

Commitment provided that, "[I]n accordance with applicable provisions of the FmHA regulations . . ., [the FmHA] will execute . . . [the] 'Loan Note Guarantee' subject to the conditions and requirements specified in said regulations. . . ." Thus, in order for the Loan Note Guarantee to be issued, twenty-nine conditions and requirements needed to be met. In addition, the lender was required to certify before the guarantee would be issued that there had been no adverse change in the condition of the borrower. The Conditional Commitment provided that:

> A Loan Note Guarantee will not be issued until the Lender certifies that it has no knowledge of any adverse change, financial or otherwise, in the Borrower, his business, or any parent, subsidiaries, or affiliates since it requested a Loan Note Guarantee.

This "adverse change" language is central to this dispute. The Conditional Commitment was to expire in December of 1983, but was extended several times through the end of 1986.

In December 1982, Wells Fargo Bank, N.A. (Wells Fargo) made a $20 million interim loan commitment to AGRI for construction of the ethanol plant, and agreed to participate in the guarantee with Mid-Kansas. AGRI began construction after the Conditional Commitment was issued and the construction loan obtained, and the plant commenced operations in early 1984. Throughout 1984, however, the plant ran at less than full capacity for a number of reasons. Wells Fargo and High Plains [2] determined that an additional $3.5 million was necessary to bring the plant to full production. After months of negotiation, in September 1985, Wells Fargo, High Plains, and the FmHA entered an agreement (the Intercreditor Agreement) which addressed the terms and conditions under

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[2] In July 1983, AGRI changed its name to High Plains.

which additional financing would be advanced by Wells Fargo. Wells Fargo sought to ensure that if they advanced additional funds and the plant reached adequate production levels, the guarantee would be issued. The Intercreditor Agreement indicated that the Loan Note Guarantee had not yet been issued "[due] primarily to difficulties in achieving adequate production levels at the Plant." The agreement stated that additional financing was being considered "[i]n order to provide additional funds to [High Plains] so as to modify and operate the Plant to achieve adequate production levels, and cause the FmHA Guarantee to be issued. . . ." The Intercreditor Agreement required, among other things, that a defaulted fluorocarbon plant loan[3] receive payment priority, and that all past due interest and principal on the fluorocarbon plant loan be paid before the loan guarantee would be issued. The Intercreditor Agreement also expressly stated that Wells Fargo was not obligated to make the loan. After the Intercreditor Agreement was signed, Wells Fargo began to advance the additional funds. The additional financing allowed High Plains to resolve the plant's technical problems, and the closing date for the Loan Note Guarantee was set for June 30, 1986.

In December 1985, Wells Fargo formally applied to replace Mid-Kansas as the lead lender. In response to a question concerning High Plains' potential ability to repay their debt, Wells Fargo indicated in their application that "[i]t is difficult to comment on the repayment schedule because of the future fluctuations in the [price] of ethanol and corn. . . ." The FmHA did not respond to Wells

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[3] In the 1970s, Southwest National Bank of Wichita made a loan to International Plastics Incorporated for a fluorocarbon plant; this loan was guaranteed by the FmHA. After International Plastics defaulted on the loan, the FmHA purchased the guaranteed portion of the loan. In 1981, AGRI sought to acquire the fluorocarbon plant for conversion to AGRI's planned ethanol plant, and offered to assume the loan on the fluorocarbon plant at a reduced interest rate. The FmHA approved this offer.

Fargo's statement regarding High Plains' ability to repay. In October 1986, Wells Fargo replaced Mid-Kansas as lead lender.

In April of 1986, the FmHA National Office advised its state directors to "immediately" inform lenders holding Conditional Commitments for alcohol production facilities (such as High Plains) that ten additional "items are to be considered in order to assure there is no adverse change in the project prior to their closing of the loan." These additional "adverse change" criteria were a new requirement for the lenders to satisfy. Almost all of the additional items for consideration required the applicant to make a projection concerning the long-term economics of the facility and the ethanol industry.

Wells Fargo was informed of the new requirements on May 29, 1986. Wells Fargo objected to the requirements, and asserted that the new requirements were contrary to discussions held in April 1985 between Wells Fargo and the FmHA. Wells Fargo, in a letter to the FmHA dated June 20, 1986, contended:

> [In April 1985, Wells Fargo and the FmHA] entered into a conversation as to what the 'no material adverse change' language meant. I thought we concluded, that although the language was vague and unclear, it did not mean changes in macro economic conditions over which the borrower and the lender has no control. I remember saying we could attempt to get the plant running to specifications, . . . but that I had no power to influence oil/ethanol prices or events in the middle east. I was assured [by FmHA representatives] that was not the intent of the FmHA.

Shortly after sending this letter, Wells Fargo forwarded the final loan documents and requested that the FmHA issue the guarantee. The FmHA refused, and extended the expiration of the Conditional Commitment until July 30, 1986. Shortly before that date, Wells Fargo again forwarded their loan documents for closing. Again, the

FmHA did not issue the guarantee, and informed Wells Fargo that a number of items needed to be "clarified, changed or furnished" before the issuance of the Loan Note Guarantee would be considered further.

Subsequently, a number of discussions, both between the parties and within the FmHA, followed over how to interpret the "adverse change" language with respect to world oil and ethanol prices. In an October 31, 1986 letter from the FmHA to Wells Fargo, the FmHA indicated its concern that Wells Fargo "remain[s] unable or unwilling to provide an acceptable certificate relating to no adverse change, financial or otherwise, in the borrower." Apparently, the FmHA was concerned that the project would have insufficient working capital, due to the continuing decline in ethanol prices. The letter also enumerated the outstanding itms that FmHA argued prevented them from issuing the guarantee. In response, Wells Fargo stated their position that they, as the lender, were not "intended to bear the risk of changes in external economic factors such as world oil prices." Wells Fargo also responded to the items of concern raised by the FmHA.

The parties continued to exchange correspondence, and, on November 17, 1986, the date for its expiration, the Conditional Commitment was extended to December 19, 1986. In response to the FmHA's concerns that the project had insufficient working capital, on November 18, 1986, Wells Fargo agreed to provide an additional $5 million in financial assistance to the project. Wells Fargo also indicated, with respect to the issue of certification of no adverse change, that they would produce an "unqualified lender's certificate," and stated, pursuant to a letter to the FmHA, that:

> In making the certification regarding material adverse change, Wells Fargo is comparing the company's ability to repay the loan when the Conditional Com-

> mitment was issued in 1982 to their ability to repay the loan today. Wells Fargo believes that there has been no material adverse change based on the company's equity, available working capital management capabilities and based on reasonable projections of commodity prices over the next few years.

The following day, on November 19th, the FmHA National Office Executive Loan Committee (NOEL Committee) met to consider the Wells Fargo proposal. Based in part on the proposed additional financing offered by Wells Fargo, the FmHA indicated that they "were satisfied with the projected economics of this project," although several unresolved details remained. In a memorandum from the Administrator of the FmHA to the Secretary of the Department of Agriculture, the Administrator indicated:

> I have concurred in the issuance of the Loan Note Guarantee to the [High Plains Project]. The lender and borrower have met or have agreed to meet prior to closing of the loan *all conditions* in the Conditional Commitment and, specifically, have met the conditions and requirements in our letter of October 31, 1986, which outlined the conditions that had not been met at that time.

(emphasis in original). On December 8, 1986, the FmHA requested that a number of items be clarified, changed, or furnished, and that these changes be received and approved by the FmHA by December 12, 1986. Changes were received by FmHA personnel on Decembr 13; these documents included an audited financial report of High Plains. This report stated that a number of factors "indicated that High Plains Corporation may be unable to continue in existence," because the ability to exist was contingent on High Plains achieving a level of profitability which, in turn, was dependant on the price of ethanol. On December 17, 1986, FmHA declined to issue the Loan Note Guarantee. This decision was formally made in a December 19, 1986 letter. The two main reasons for the

denial were: 1) the audited financial report indicated that, based on the current price of ethanol, High Plains would not generate sufficient cash flow to meet its obligations; and 2) the FmHA had lost confidence in High Plains' management based on what the FmHA viewed as "numerous decisions which have caused adverse consequences."

Wells Fargo appealed the decline of the loan guarantee under FmHA procedures. The hearing took place on May 21, 1987 before the FmHA's state director for Louisiana. The state director did not overturn the FmHA's determination, but did recommend that the FmHA reconsider its refusal to issue the guarantee in light of the improvement in ethanol prices. In July 1987, the Administrator of the FmHA denied Wells Fargo's appeal. Wells Fargo filed its complaint in this court on January 22, 1988.

After hearing oral argument in this case, the court noted that a settlement between the parties would be a particularly practical solution for both parties. This was so because at the time of the argument, the ethanol plant was still operating (and to the court's knowledge, still is) and was financially solvent. The court concluded that the most efficient way to resolve the dispute would be for the government to issue the guarantee, rather than for the parties to litigate the rather complex measure of damages suffered by Wells Fargo. For whatever reason, the parties were not able to settle and the government has not issued the guarantee. Therefore, the court must render this opinion and will proceed to trial on the damages issue.

DISCUSSION

I. The Existence of a Contract.

The jurisdiction of the Claims Court in this case is conferred by the Tucker Act, which provides that the court is permitted:

> to render judgment upon any claim against the United States founded either upon the Constitution, or any

> Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.

28 U.S.C. § 1491. Defendant asserts that the Claims Court lacks jurisdiction over this case under the Tucker Act because the FmHA did not have a contract with Wells Fargo that would require the issuance of the loan guarantee. Defendant characterizes the Conditional Commitment simply as the FmHA's method of informing the involved parties that their documents submitted at that time had been approved subject to the completion of certain conditions. In the government's view, the Conditional Commitment did not obligate the lender and borrower in any way, because FmHA regulations allow the lender or borrower to notify the FmHA at any time after issuance of the Conditional Commitment that they no longer wish to proceed with the issuance of the guarantee. Therefore, the government also would not be bound. Defendant further argues that, even if contractual consideration had been furnished by Wells Fargo, which the government contests, any considerations would be vitiated by virtue of the fact that a complete escape from the contract existed—Wells Fargo was free to inform the FmHA at any time that they wished to withdraw.

Defendant also argues that, because there was a regulatory framework with which the parties must comply in order for a loan guarantee to issue, there was no "mutual intent" to bind the government to issue the guarantee, because compliance with the requirements was a necessary prerequisite. Defendant further contends that none of the government officials had the authority to bind the United States to issue the loan guarantee before all the regulatory requirements were satisfied.[4]

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[4] Under *Deakins v. United States*, 3 Cl.Ct. 97 (1983), the FmHA officials must have been acting within the scope of their authority. Defendant argues that issuing a loan guarantee was not within

The court disagrees with the contentions of the government. The court finds that the FmHA's Conditional Commitment and the Intercreditor Agreement were conditional contracts to issue a Loan Note Guarantee, and the existence of the Conditional Commitment and the Intercreditor Agreement induced plaintiff to make loans it otherwise would not have made. The court finds that the Conditional Commitment constitutes a unilateral contract, where one party makes a promise as consideration for the contract, and the contract is deemed to be accepted when the other party begins performance. "There is ample case law holding that a contractual relationship arises between the government and a private party if promissory words of the former induce significant action by the latter in reliance thereon." *National Rural Utilities Cooperative Finance Corp. v. United States,* 14 Cl.Ct. 130, 137 (1988), *aff'd,* 867 F.2d 1393 (Fed.Cir.1989), *citing Himfar v. United States,* 355 F.2d 606, 174 Ct.Cl. 209, 214-15 (1966); *Padbloc Co. v. United States,* 161 Ct.Cl. 369, 378-79 (1963); *Radium Mines, Inc. v. United States,* 153 F.Supp. 403, 139 Ct.Cl. 144, 147-48 (1957). *See also Grav v. United States,* 14 Cl.Ct. 390, 393 (1988), *aff'd,* 886 F.2d 1305 (Fed.Cir.1989). Thus, where a unilateral contract is at issue, the fact that only one party has made a promise does not imply that a contract does not exist. A contract comes into existence as soon as the other party commences performance.

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the scope of the authority of the FmHA officials who signed the Conditional Commitment. However, the issue at this point is not whether these officials had the authority to grant a guarantee, but whether these officials had the authority to obligate the FmHA to a Conditional Commitment. Defendant does not argue that the FmHA officials lacked authority to sign the Conditional Commitment or the Intercreditor Agreement. Defendant's failure to proffer any evidence of or basis for such an absence of authority defense indicates that "FmHA officials [were] acting within the scope of their authority" when they issued the Conditional Commitment and the Intercreditor Agreement. 3 Cl.Ct. at 101.

Pursuant to the Conditional Commitment, the FmHA offered to guarantee financing if the conditions set forth in the Conditional Commitment were met. Wells Fargo began performance by advancing $20 million for construction of the ethanol plant. Wells Fargo and High Plains worked together to complete a fully operational ehtanol plant. The court holds that, even prior to the September 9, 1985 Intercreditor Agreement, the FmHA could not have withdrawn its offer to issue a Loan Note Guarantee subject to the conditions, since, by investing funds in the project in reliance on the FmHA's offer to issue the guarantee, plaintiff had already begun performance. It is basic hornbook law that, where an offer invites an offeree to accept by rendering a performance, the contract is created when the offeree "tenders *or begins* the invited performance." Restatement (Second) of Contracts § 45 (emphasis added). While the FmHA was not legally obligated to issue the guarantee when plaintiff commenced performance, it was obligated to give the plaintiff a reasonable chance to meet the required conditions, and if plaintiff did meet the conditions, to issue the guarantee. "[W]here no time limit is given, it is presumed that performance will be completed within a reasonable time." *Societe Anonyme des Ateliers Brillie Freres v. United States,* 160 Ct.Cl. 192, 201 (1963). It follows that, if no time limit for performance is contained within the contract, the offeror must allow the offeree a reasonable time under the circumstances within which his performance may be rendered. Thus, by loaning High Plains $20 million for construction of the ethanol plant in reliance on the Conditional Commitment, Wells Fargo commenced performance and a contract was formed.

In addition to the Conditional Commitment, the Intercreditor Agreement also constitutes a contract. As discussed above, in 1984, Wells Fargo and High Plains determined that an additional $3.5 million would be necessary to allow the plant to produce ethanol at full capacity. Before Wells Fargo agreed to advance the additional

funds, and after months of negotiation, Wells Fargo, High Plains, and the FmHA signed the Intercreditor Agreement. The agreement stated that the parties entered into the agreement, *inter alia*, "to induce Wells Fargo to consider" loaning High Plains the additional $3.5 million. As the Intercreditor Agreement indicated, Wells Fargo intended, through its additional investment, to "cause the FmHA Guarantee to be issued." The Intercreditor Agreement called for the issuance of the Loan Note Guarantee "upon compliance with the conditions of the commitment and FmHA regulations."[5] The court finds that the language of the Intercreditor Agreement and the actions of the parties indicate that a contract existed between the parties. Under that agreement, the FmHA would be obligated to issue the Loan Note Guarantee once the conditions were satisfied. Pursuant to the Intercreditor Agreement, plaintiff advanced High Plains the $3.5 million to modify the plant. The court finds that the Conditional Commitment and the Intercreditor Agreement constitute contracts that bind the FmHA to issue the guarantee if the conditions were satisfied. The FmHA was not free to withdraw its offer or to refuse to determine if the conditions were, in fact, satisfied.

This subject is not one of first impression for this court. A Conditional Commitment was found to embody a contractual relationship in *Deakins v. United States*, 3 Cl.Ct. 97 (1983). In *Deakins*, the Conditional Commitment was found to be:

> an agreement between the plaintiff and the government, reflecting a considerable amount of negotiation and communication, which was signed by the FmHA officials acting within the scope of their authority. Under the agreement plaintiff was induced to build homes by the promise that if homes were built in accordance with FmHA requirements, low interest loans

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[5] There is no dispute between the parties as to regulatory compliance.

> would be made available by the government to eligible purchasers.

3 Cl.Ct. at 101. Although the *Deakins* court ultimately concluded that the government had not breached its contract because the plaintiff failed to satisfy FmHA requirements, the court's conclusion that a Conditional Commitment was evidence of a contractual relationship supports a similar legal conclusion here.

The defendant attempts to distinguish *Deakins* by arguing that *Deakins* involved FmHA "Rural Housing Loans," not FmHA "Business and Industrial Loans." The Rural Housing Loan program required payment of a fee in order to apply for a conditional commitment. The court does not find this distinction persuasive. The government further argues that this court should follow the Seventh Circuit's opinion in *Runnemede Owners, Inc. v. Crest Mortgage Corp.*, 861 F.2d 1053, 1054 (7th Cir. 1988). In that case, the mortgage company issued a "commitment" letter to the purchaser of a hotel for a loan. The court indicated that the commitment letter constituted the mortgage company's agreement to make the loan *subject to a number of conditions,* and thus was not a binding obligation. *Id.*

The court finds *Runnemede* inapplicable under the facts of this case. In *Runnemede,* the mortgage company only bound itself to *consider* making the loan once the conditions were satisfied. Here, in contrast, the language of the Conditional Commitment clearly states that the FmHA "will execute" the Guarantee once the conditions are met. There is significantly less discretion—if indeed, there is any discretion at all—on the part of the FmHA to issue the loan guarantee once the conditions have been satisfied than there was in *Runnemede.* In addition, in *Runnemede,* the court did not find that plaintiff had taken any action in reliance on the letter. In contrast, here plaintiff advanced millions of dollars, both in reliance on the Conditional Commitment and on the Intercreditor Agreement.

In concluding that the Conditional Commitment was a contract, the court in *Deakins* relied upon the fact that the FmHA's promises induced the plaintiff to act. Similarly here, the FmHA promised to issue a guarantee upon satisfaction of the conditions in the Conditional Commitment; this promise induced Wells Fargo to make loans it otherwise would not have made. Former FmHA Business and Industrial Loan Program Director John Swinnea stated in his deposition, "[t]he purpose of the lender program is to get banks to make loans they otherwise wouldn't make." In former FmHA Administrator Vance Clark's deposition, he agreed that if plaintiff did "indeed meet the conditions of that commitment, we are legally bound to make that guarantee and we were required to do it." Based on the unilateral contract between the parties, if those conditions are satisfied, the FmHA must issue the loan guarantee or be in breach of its contract.[6]

II. The "Adverse Change" Language.

As discussed earlier, the language of the Conditional Commitment provided that:

> A Loan Note Guarantee will not be issued until the Lender certifies that it has no knowledge of any adverse change, financial or otherwise, in the Borrower, his business, or any parent, subsidiaries, or affiliates since it requested a Loan Note Guarantee.

The court finds that this requirement of "no adverse change" does not apply to conditions outside an appli-

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[6] Because of the court's conclusion that a contract existed between the parties, it is not necessary to reach the plaintiff's equitable estoppel argument. That argument, set forth in count IV of the complaint, contends that the FmHA acted to cause Wells Fargo to believe that a Loan Note Guarantee would be issued, and therefore, that the FmHA should be estopped from denying its obligations to issue the guarantee. However, even if the court had concluded that no contract existed, summary judgment on the estoppel claim would be inappropriate as a factual inquiry would be necessary.

cant's control for which the applicant has not assumed the risk. This interpretation is consistent with the congressional intent of the ethanol loan guarantee program, as well as the long-recognized desire of out legal system to avoid forfeiture where possible.

A. *Legislative Intent*

An examination of the congressional purpose for the ethanol loan guarantee program is helpful in ascertaining the context within which the 1982 Conditional Commitment, containing the "adverse change" language, was drafted. The ethanol loan guarantee program under the Consolidated Farm and Rural Development Act sought to achieve specific social goals, including the development of alternative, renewable energy sources; the creation of an enlarged grain market; and the promotion of increased employment in rural areas. The uncertain economic viability of ethanol, and particularly, ethanol's inability to be price competitive unless crude oil prices rose, caused private lenders to deny loans for the construction of ethanol plants. To combat the lack of investment, Congress provided economic incentives to lending institutions by guaranteeing 90% of the financing.

The economic uncertainty in the ethanol industry is precisely what necessitated the loan program that was designed to attract financing that would be unavailable under normal commercial terms. It follows that, if lender banks, rather than the government, were to bear the risk that uncertain ethanol prices might affect a plant's cash flow which would prevent the loan guarantee from being issued, lenders would be just as unlikely to issue the loans as they would be in the absence of the federal loan guarantee program. If the FmHA did not assume at least some of the risk of the unstable market, the loan guarantee program would not offer any incentive for lenders to advance ethanol loans. If the FmHA did not bear the risk of a weak, worldwide ethanol market, then it bore no risk

at all. The government's position in this case would undercut the legislative rationale for the ethanol program.

Under the government's interpretation of "adverse change," the FmHA would only be required to issue a loan guarantee if the ethanol market were sound; this, however, would be a meaningless gesture because a lender would presumably not need a guarantee if the ethanol market was flourishing. Lenders were not making ethanol loans on their own because the market was unstable. It is implicit that a lender would only make an ethanol loan if it was guaranteed against the acknowledged instability of the ethanol market. The government's interpretation of the "adverse change" language thus cannot be correct.

B. *Avoidance Of Forfeiture*

The April 16, 1986 memorandum from the FmHA Administrator directed FmHA state directors to consider world ethanol and oil prices when determining whether any adverse change had occurred, and listed ten items for consideration in determining "adverse change." Prior to this, there was no indication of what factors would be considered in determining "no adverse change." The April memorandum was written after plaintiff had advanced the initial $20 million loan.

Under the FmHA's interpretation of adverse change, the FmHA could avoid guaranteeing the loan because of the occurrence of events beyond plaintiff's control, such as the existence of low ethanol prices. Thus, the FmHA's interpretation could lead to a forfeiture by a fully-performing party. Contract provisions that condition a duty on the occurrence of an event are properly interpreted to reduce the risk of forfeiture, unless the party at risk of forfeiture clearly assumed the risk that the condition would not be fulfilled:

> In resolving doubts as to whether an event is made a condition of an obligor's duty, . . . an interpretation

> is preferred that will reduce the obligee's risk of forfeiture, unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk.

Restatement (Second) of Contracts, § 227(1) (1981). Comment c to § 227(1) further explains that "[w]here the language is doubtful, an interpretation is generally preferred that will avoid" the risk of forfeiture. A party risks forfeiture if the nature of the condition is such that uncertainty is not likely to be resolved until after the obligee has performed. Restatement (Second) of Contracts § 227(1) (comment b). An interpretation resulting in forfeiture is particularly disfavored when the purportedly unfulfilled condition is outside the control of a party who has already performed. "If the event is within [the obligee's] control, he will often assume the risk. If it is not within his control, it is sufficiently unusual for him to assume the risk that, *in case of doubt, an interpretation is preferred under which the event is not a condition.*" *Id.* (emphasis added). *See also Bank of Advance v. United States*, 6 Cl.Ct. 535, 538, n. 3 (1984) (court prefers interpretation that reduces the risk of forfeiture).

The plaintiff clearly did not assume the risk of low ethanol prices. The Conditional Commitment did not specify that the loan guarantee was contingent upon high ethanol prices or upon a healthy world ethanol market. Low ethanol prices were "a reasonably foreseeable event given the climate" of the ethanol industry in the 1980s. The FmHA could have structured the Conditional Commitment to shift the risk of an uncertain ethanol market to the plaintiff by defining "adverse changes," but this was not done.

The FmHA's interpretation in 1986 of what would constitute an adverse change led to a forfeiture by plaintiff. By interpreting the Conditional Commitment's "adverse change" language to exclude changes in macroeconomic conditions beyond plaintiff's control, such a forfeiture can

be avoided. Thus, the FmHA cannot deny an ethanol loan guarantee, pursuant to the "adverse change" provision of the 1982 Conditional Commitment, on the basis of low ethanol prices, weak oil or ethanol markets, or any other similar condition that is beyond plaintiff's control and for which the plaintiff did not assume the risk.

III. The Contractual Obligations.

The remaining issue is whether plaintiff satisfied the conditions of the contract, thereby making the FmHA's failure to issue the Loan Note Guarantee a breach of the contract. As discussed earlier, in October 1986, the FmHA expressed its concern that the project would have insufficient working capital, due to the decline in ethanol prices. In response to the FmHA's concerns, on November 18, 1986, plaintiff agreed to provide High Plains an additional $5 million of financial assistance to insure that the plant had an adequate cash flow. This $5 million cash infusion was intended to alleviate the FmHA's concerns. Apparently it did, because on November 19, 1986 the FmHA National Office Executive Loan Committee (NOEL Committee) agreed to accept plaintiff's certification that there had been no adverse change, and, on November 26, FmHA Administrator Vance Clark wrote plaintiff that "[i]f Wells Fargo provides such additional assistance, then FmHA is satisfied with projected economics of this project." Also on November 26, Administrator Clark informed Department of Agriculture Secretary Richard Lyng that plaintiff had satisfied all conditions to the guarantee that existed as of October 31, 1986:

> The lender and borrower have met or have agreed to meet prior to closing of the loan *all conditions* in the Conditional Commitment and, specifically, have met the conditions and requirements in our letter of October 31, 1986, which outlined the conditions that had not been met at that time. . . .
>
> . . . .

> As you well know, I have been very reluctant to approve the 1982 commitment and would not do so until *all* commitment requirements were met. The cash flow requirement was, of course, primary and their $5 million cash infusion has assured that.

(emphasis in original). In addition, Administrator Clark wrote a letter to Congressman Coelho of California on December 3rd, notifying him that the efforts of all concerned parties "are now culminating in the granting of the guarantee," and that the FmHA was now "able to . . . legally issue the guarantee." In spite of these actions, however, the FmHA refused to issue the loan guarantee on December 17th, less than one month after this correspondence.

On December 19th, the FmHA sent a letter to Wells Fargo stating that the guarantee would not be issued, and indicating that their decision was based on the fact that "an adverse change in the financial condition of High Plains Corporation during the period of time between the issuance of the Conditional Commitment for Guarantee in 1982 and December 17, 1986" had occurred. Two reasons were given by the FmHA to support their decision. First, the FmHA relied on an audited report from the accounting firm Peat, Marwick, Mitchell and Company that indicated that, based on the low price of ethanol and the high cost of milo (a type of grain), High Plains would not be able to generate sufficient cash flow to meet its obligations. Second, the FmHA contended that they had lost confidence in the management of High Plains due to numerous management decisions with adverse results. Eight examples to support this latter contention were given:

> a. The Environmental Protection Agency brought suit against High Plains. The court imposed a fine on High Plains in 1985 as a result of that suit.
>
> b. The audited financial report indicated net losses for 1984, 1985, and 1986. Ethanol prices for those

years were at a level where other ethanol producers were profitable.

c. Although the plant was scheduled to go into full production in 1984, the plant was unable to reach designed capacity until April 1986.

d. Numerous extensions of the Conditional Commitment were made at the request of High Plains.

e. Concerning access to the plant, High Plains merely possessed a one-year renewable right of ingress and egress with a limited right to renew, instead of clear ownership of access as initially claimed.

f. Corporate cash flows inaccurately reflected the terms of the $20 million loan agreement and note.

g. In preparing for closing, it was revealed that several unanticipated obligations (approximately $550,000) of High Plain's would have to be paid from the loan proceeds.

h. Since issuance of the Conditional Commitment in 1982, High Plains incurred substantial unanticipated new debt and would need to incur further new debt immediately.

The government has indicated that the December 19, 1986 letter contains all the reasons for the denial of the guarantee.

As discussed above, defendant may not refuse to issue the guarantee based on conditions outside plaintiff's control for which the plaintiff did not assume the risk of forfeiture. Therefore, defendant's first reason for denying the guarantee, insufficient cash flow due to low ethanol prices, is not a legally sufficient reason. Therefore, the FmHA's denial of the guarantee must rest on the second reason offered by the FmHA—the High Plains management problems. The court concludes that the eight reasons provided by the FmHA to support their allegation of poor management by High Plains are not a sufficient

basis to demonstrate that High Plains had suffered an adverse change under the contract. The court finds that the eight reasons enumerated in the December 19th letter do not constitute grounds for the FmHA's refusal, because the reasons were known prior to the signing of the Intercreditor Agreement and prior to the approval by the NOEL Committee.

Plaintiff points out that every example of poor management given in the December 19th letter, with the possible exception of certain fees, had been known by the FmHA when the NOEL Committee and Administrator Clark indicated their approval of the guarantee in November. In addition, many of the eight reasons offered by the FmHA in the December 19th letter to support its decision occurred prior to the signing of the Intercreditor Agreement on September 9, 1985. For example, the fine imposed as a result of the suit by the Environmental Protection Agency was levied against High Plains in 1985. In addition, the fact that the plant did not go into full production in 1984 due to operational and environmental problems clearly was known in September 1985. Finally, plaintiff contends, and the government does not dispute, that two of the remaining reasons—the form of payment on the loan guarantee and additional obligations that would be required to be paid from loan proceeds—had also been known to the FmHA prior to the signing of the Intercreditor Agreement. Concerning the additional obligations, plaintiff points out the $180,000 of those obligations represent the FmHA's *own* guarantee fee. These enumerated reasons cannot support the FmHA's decision to refuse to issue the loan guarantee because they did not prevent the FmHA from signing the Intercreditor Agreement. Despite being aware of these "adverse" conditions, the FmHA executed the Intercreditor Agreement in the Fall of 1985, pursuant to which plaintiff advanced an additional $3.5 million.

The court does not find convincing or legally sufficient the remaining reasons offered in the December 19th letter.

The "unanticipated new debt" cited by the FmHA in the December 19th letter as further evidence to support its decision to deny the guarantee *was the additional $3.5 million that the FmHA induced Wells Fargo to loan through the Intercreditor Agreement!* To accept such reasoning would be like the court shooting a plaintiff's parents and then denying him relief because he was an orphan, to paraphrase an old joke. Thus, it appears that the FmHA signed the Intercreditor Agreement to induce the plaintiff to provide additional funding to High Plains, only to later claim that the existence of that additional debt was a reason to deny the guarantee. FmHA-induced debt can not constitute an adverse change. Defendant is at best disingenuous in this "reason." Similarly, the extensions of time for the Conditional Commitment were agreed to by the FmHA, and thus can not be counted against the plaintiff.

The FmHA's concern about the possibility of High Plains losing road access to the plant rings hollow. Access to the plant was available through two sources. The one referred to by the FmHA was created through a license agreement with Kansas Gas & Electric. High Plains entered into the license agreement to avoid the cost of paving the other source of access. When it was discovered in December 1986 that High Plains did not own the land over which the other access road would travel, High Plains arranged to purchase the land from the actual owner. Defendant did not rebut the fact that on December 16th, one day before the proposed day of the loan guarantee closing, the owner of that property was ready and willing to sell High Plains the land. Since defendant did not successfully rebut plaintiff's assertion that the access problem could easily have been resolved, and would have been resolved if the parties had gone through with the loan guarantee closing, that fact cannot be a valid reason for denying the guarantee.

Another reason offered by the FmHA was the evidence contained in the 1986 audited financial report which indi-

cated that High Plains had experienced net losses in 1984, 1985, and 1986. However, an analogous situation existed prior to the signing of the Intercreditor Agreement. The 1984 audited financial report concluded that High Plains had incurred a net loss of $2.3 million during the year ending June 30, 1984, and indicated that High Plains "may be unable to continue in existence." In spite of this, the FmHA was willing to sign the Intercreditor Agreement. The FmHA certainly knew that High Plains had suffered losses in 1984 and 1985 when it signed the Intercreditor Agreement.

Furthermore, on December 17th, the day the guarantee was denied, the FmHA drafted a rejected notice on a standard FmHA form stating that the guarantee had been denied: 1) because there had been an adverse change in High Plains' financial condition; and 2) because High Plains had inadequate working capital and resources. The "serious concerns about the credibility of [High Plains] management," which was one of the two reasons for refusing to issue the guarantee given in the December 19th letter, did not even appear in the December 17th FmHA draft rejection form. None of the eight items listed in support of the second reason in the December 19th letter were included in the December 17th form. Notwithstanding the fact that FmHA regulations call for a denial to be sent on this standard FmHA rejection form, 7 C.F.R. § 1980.61(e) (1986), the FmHA did not send the rejection form but instead sent the December 19th letter.

The courts finds no evidence to prove that High Plains had suffered an adverse change. The evidence offered by the FmHA in the December 19th letter to support their allegation of poor management by High Plains does not support a finding that an adverse change had taken place. Most factors cited by the FmHA were known prior to the FmHA entering into the Intercreditor Agreement and prior to the FmHA indicating informally that the guarantee would be issued. Because the cited reasons did not prevent the FmHA from entering into the Intercreditor

Agreement or from informally approving the issuance of the guarantee, they cannot be sufficient reasons for refusing to issue the guarantee. In addition, the FmHA may not deny the guarantee based on conditions outside the control of plaintiff for which the plaintiff did not assume the risk of forfeiture—for, example, low ethanol prices. The court finds that, because the conditions contained in the Conditional Commitment were met, the government breached its contract to issue the loan guarantee.

IV. Plaintiff's *Quantum Meruit* Claim

In Count III of its complaint, Wells Fargo claims that it is entitled to recover payments made in connection with the defaulted fluorocarbon plant loan insofar as those payments were made at plaintiff's expense. Plaintiff characterizes this claim as one for unjust enrichment—"a *quantum meruit* claim . . . on a contract implied-in-fact." Wells Fargo argues that payments on the defaulted loan were made in anticipation of the loan guarantee being issued, and that the FmHA was unjustly enriched through receipt of these payments.

In order for the court to find an implied-in-fact contract between the parties, there must have been a meeting of the minds of the parties to the contract, which is inferred from the parties' conduct such that a "tacit understanding and agreement" was reached. *Fincke v. United States,* 675 F.2d 289, 230 Ct.Cl. 233, 244 (1982) (citation omitted). Defendant argues that, in order for an implied-in-fact contract to exist here, plaintiff would need to show that an agreement existed between Wells Fargo and the FmHA that Wells Fargo should recover from the FmHA the payments made by High Plains to the Kansas bank which had issued the FmHA-guaranteed loan. Defendant contends, and the plaintiff does not dispute, that plaintiff did not show that an implied-in-fact contract existed. At most, plaintiff could argue that a contract implied-in-law exists. An implied-in-law contract is a fiction created

by the court to provide an equitable remedy and does not take into consideration the intention of the parties. Instead, the court imposes a quasi-contractual obligation on the parties to bring about justice.

The court declines to reach the issue of whether an implied-in-law contract existed, because although the Claims Court possesses jurisdiction over implied contracts pursuant to the Tucker Act, 28 U.S.C. § 1491, that jurisdiction has been construed to apply only to contracts implied-in-fact and not to contracts implied-in-law. *United States v. Mitchell,* 463 U.S. 206, 218, 103 S.Ct. 2961, 2968, 77 L.Ed.2d 580 (1983). Thus, a suit based on a theory of *quantum meruit* or unjust enrichment is a suit based on a contract implied-in-law, and the Claims Court does not possess jurisdiction over such claims. *See, e.g., United States v. Mitchell,* 463 U.S. at 208, 103 S.Ct. at 2963; *Fincke v. United States,* 675 F.2d at 296-97, 230 Ct.Cl. at 246-47. Therefore, the defendant's motion for summary judgment with respect to count III of the complaint is granted.

CONCLUSION

The 1982 Conditional Commitment and the Intercreditor Agreement constitute contracts between Wells Fargo and the government. With respect to the language of the Conditional Commitment which required the lender to certify that no "adverse change" had occurred in the borrower, that language is inapplicable to conditions outside a lender's control for which the lender did not assume the risk. Plaintiff fulfilled its contractual obligations, and the defendant refused to issue the loan guarantee. Such refusal to issue the guarantee constituted a breach of the contract.

For the reasons set forth above, the government's motion for summary judgment is DENIED, except insofar as it addresses plaintiff's *quantum meruit* claim. The plaintiff's motion for partial summary judgment is

GRANTED with respect to the existence and breach of the contract.

The parties are ordered to file a joint status report within 60 days of the issuance of this opinion addressing further proceedings in this case, including those proceedings necessary to resolve the issue of the appropriate amount of monetary damages to be awarded.

IT IS SO ORDERED.